

UNITED STATES OF AMERICA
POSTAL REGULATORY COMMISSION
WASHINGTON, DC 20268-0001

Before Commissioners:

Robert G. Taub, Chairman;
Michael Kubayanda, Vice Chairman;
Mark Acton;
Ann C. Fisher; and
Ashley E. Poling

Statutory Review of the System
for Regulating Rates and Classes
for Market Dominant Products

Docket No. RM2017-3

REVISED NOTICE OF PROPOSED RULEMAKING



Washington, DC 20268-0001
December 5, 2019

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Attachment A—Proposed Rules

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I. INTRODUCTION AND PROCEDURAL HISTORY

Pursuant to the directives in section 3622 of the Postal Accountability and Enhancement Act (PAEA),¹ the Commission conducted a review of whether the system for regulating rates and classes for Market Dominant products achieved the objectives of 39 U.S.C. § 3622(b), taking into account the factors enumerated in 39 U.S.C. § 3622(c). The objectives of the PAEA reflected the goals to create a “flexible, stable, predictable, and streamlined ratemaking system that ensures the Postal Service’s

¹ Postal Accountability and Enhancement Act (PAEA), Pub. L. 109-435, 120 Stat. 3198 (2006).

financial health (in significant part through rate adjustments, costs reductions, and increased efficiency) and maintains high quality service standards and performance.”²

The Commission’s review included a comprehensive analysis of whether the PAEA system achieved the nine objectives, taking into account the factors.³ As a result of this review, the Commission determined that the overall PAEA system “has not achieved the objectives taking into account the factors of the PAEA.” Order No. 4257 at 4, 275. The Commission issued Order No. 4257, which set forth the findings from its review.

In response to its findings and conclusions and as contemplated by section 3622(d)(3),⁴ the Commission issued a Notice of Proposed Rulemaking (NPR) on December 1, 2017.⁵ In the NPR, the Commission proposed to amend part 3010 of title 39 of the Code of Federal Regulations by replacing certain rules in their entirety, moving rules, and making minor changes to existing rules as necessary to achieve the objectives of 39 U.S.C. § 3622(b). Order No. 4258 at 3. The NPR sought public comment on the Commission’s proposals to modify the system for regulating rates and classes. The Commission received a wide range of comments on the proposals. As explained below, based on the comments filed and additional consideration, the

² Order on the Findings and Determination of the 39 U.S.C. § 3622 Review, December 1, 2017, at 2 (Order No. 4257).

³ The Commission commenced its review by issuing an Advance Notice of Proposed Rulemaking on December 20, 2016, seeking comments. Advance Notice of Proposed Rulemaking on the Statutory Review of the System for Regulating Rates and Classes for Market Dominant Products, December 20, 2016 (Order No. 3673).

⁴ Section 3622(d)(3) provides that “[i]f the Commission determines, after notice and opportunity for public comment, that the system is not achieving the objectives in subsection (b), taking into account the factors in subsection (c), the Commission may, by regulation, make such modification or adopt such alternative system for regulating rates and classes for market-dominant products as necessary to achieve the objectives.” 39 U.S.C. § 3622(d)(3).

⁵ Notice of Proposed Rulemaking for the System for Regulating Rates and Classes for Market Dominant Products, December 1, 2017 (Order No. 4258).

Commission issues this Revised Notice of Proposed Rulemaking (Revised NPR), which proposes new changes to the regulations and modifies and clarifies previous proposals.⁶

⁶ Pending before the Commission is Docket No. RM2019-13, which proposes to renumber part 3010 to part 3030 and part 3020 to part 3040. In the instant docket and Order, for simplicity and clarity, the Commission uses the existing part numbers which appear in the Code of Federal Regulations. Any future numbering changes adopted in Docket No. RM2019-13 will be incorporated into the final order issued in Docket No. RM2017-3.

II. OVERVIEW

A. The Need for Modifications to the System of Ratemaking

As a part of its overall analysis of the ratemaking system, the Commission reviewed three areas that encompassed the nine objectives of the PAEA. Order No. 4257 at 3. The three principal areas were: (1) the structure of the ratemaking system; (2) the financial health of the Postal Service; and (3) service. *Id.* at 22. Each of these areas was further divided into subtopics, and the objectives of the PAEA were examined in conjunction with each other “in order to examine whether the objectives have been achieved for the system as a whole.”⁷

Applying this framework, the Commission concluded that while the system achieved some of the goals, the overall system had not achieved the objectives taking in account the factors of the PAEA. *Id.* at 4. The Commission’s review of the structure of the ratemaking system and the related objectives determined that the system was mostly successful in meeting those objectives. *Id.* With respect to the subtopic of the ratemaking process, the Commission concluded that “the structure of the ratemaking process created by [the] PAEA has worked as intended to create predictably and stably timed price adjustments, reduce the administrative burden by reducing the complexity of rate proceedings, and increase the transparency of the ratemaking process due to the availability of comprehensive and understandable material.” *Id.* at 48. With respect to the subtopic of pricing, the Commission concluded that “the system has allowed the Postal Service pricing flexibility and achieved rates that are just and predictable and stable in magnitude,” but it did not result in increased pricing efficiency. *Id.*

⁷ *Id.* The structure of the ratemaking system analysis included the subtopics of the ratemaking process and pricing. *Id.* The financial health analysis included the subtopics of financial stability, costs and operational efficiency, reasonable rates, mail security and terrorism deterrence, and institutional cost allocation. *Id.* The service section included the subtopics of service standards and service performance. *See id.*

The Commission's finding with regard to pricing efficiency was based on analysis of whether the price and cost relationships in workshared mail adhered to Efficient Component Pricing (ECP) and allocative efficiency principles. *Id.* at 130. The Commission concluded that the system did not result in pricing efficiency because "workshare discounts were not set as close as practicable to their avoided costs despite the Postal Service's ability to do so under the price cap" in conjunction with the fact that "seven products did not cover their attributable costs during the PAEA era." *Id.* at 145.

Next, the Commission reviewed the finances of the Postal Service and related objectives and determined that the system did not meet the objectives relating to the financial health as intended by the PAEA. *Id.* at 146-148. The Commission determined that "[a]lthough the system is appropriately allocating institutional costs and the Postal Service has been able to maintain financial stability in the short-term...the Postal Service has not been financially healthy under the current ratemaking system." *Id.* at 148. Specifically, the Commission stated that "financial stability, including retained earnings, has not been maintained for the Postal Service in the medium and long-term time frames and that cost reductions and operational efficiency gains have not been maximized." *Id.* The Commission also found that "reasonable rates were not achieved under the current system, further contributing to the poor financial health of the Postal Service." *Id.*

As part of this review, the Commission also analyzed the conditions impacting the Postal Service's financial health after the implementation of the PAEA. The consumer price index (CPI)-based price cap system set forth by the PAEA was intended to enable the Postal Service "to generate sufficient revenue to 'respond to all circumstances it is likely to face in the normal course of business.'"⁸ Prior to the PAEA, the Postal Service paid its share of retiree health premiums on a pay-as-you-go basis.

⁸ *Id.* at 37 (citing S. Rep. 108-318 at 11 (2004); H.R. Rep. 109-66, pt. 1, at 118 (2005)).

The PAEA created a new obligation for the Postal Service that required it to provide future Retiree Health Benefits Fund (RHBF) payments averaging \$5.6 billion per year beginning in FY 2007 through FY 2016.⁹ During this 10-year period, the Postal Service was not required to pay the normal costs of retiree health benefits (RHB) or to make amortization payments toward the unfunded portion of its RHB liability.¹⁰ Shortly after passage of the PAEA with these new requirements, the Postal Service was greatly impacted by the Great Recession, “which had a substantial negative impact on Postal Service volume and revenues.”¹¹ Further, the Commission determined that this “economic downturn occurred in concert with emergent technological trends that resulted in even greater declining volumes for First-Class Single-Piece Mail.”¹²

The Commission analyzed the impact of these changing conditions on the Postal Service’s financial health throughout the PAEA era and concluded that the aggressive RHBF prefunding along with reductions in volume and revenue added to net losses experienced by the Postal Service during the PAEA era. Order No. 4257 at 38-40. From FY 1995 through FY 2005, the Postal Service reported a cumulative net income of \$11.3 billion.¹³ Over the period FY 2006 through FY 2016, the Commission noted that the Postal Service suffered a cumulative net loss of \$59.1 billion. Order No. 4257 at 171. In its review of the financial health of the Postal Service, the Commission concluded that “although the statutorily compliant CPI-based price cap system was anticipated, at the time of its implementation, to enable the Postal Service to produce

⁹ Order No. 4257 at 37 (citing Pub. L. 109-435 § 803; 5 U.S.C. § 8909a(d)(3)(A)).

¹⁰ Normal costs are the actuarially-determined amounts for current employees’ future retiree benefits, while amortization costs are actuarially-determined amounts required to fully fund the RHB liability over time.

¹¹ Order No. 4257 at 38 (citing Docket No. R2013-11, Order Granting Exigent Price Increase, December 24, 2013 (Order No. 1926)).

¹² Order No. 4257 at 38 (referring to Order No. 1926).

¹³ *United States Postal Service Annual Report to Congress*, Fiscal Years 1995-2005, available at: https://www.prc.gov/dockets/usps_reports.

sustained net income and generate retained earnings, that has not occurred.” *Id.* at 148.

In its review of service, the Commission determined that the system did not effectively encourage the maintenance of high quality service standards. *Id.* at 4-5, 250. The Commission analyzed two aspects of service. First, it looked at whether the PAEA system encouraged “the maintenance of high quality service standards established pursuant to 39 U.S.C. § 3691.” *Id.* Second, the Commission examined whether the Postal Service was held “accountable for consistently achieving those standards.” *Id.* at 261. For the first part of this analysis, the Commission found that “service standards declined during the PAEA era, because the Postal Service reduced the high quality service standards that were set in 2007.” *Id.* at 273. For the second part of the analysis, the Commission concluded that the Commission’s *Annual Compliance Determination* (ACD) “has been and continues to be the proper vehicle for addressing issues related to service performance.” *Id.*

Overall, based on this review of the structure of the ratemaking system, the financial health of the Postal Service, and service, the Commission concluded that “while some aspects of the system of regulating rates and classes for market dominant products have worked as planned, overall, the system has not achieved the objectives of the PAEA.” *Id.* at 5. Accordingly, the Commission issued the NPR setting forth proposed rules to address the shortcomings of the system of ratemaking based on the conclusions in Order No. 4257.

B. Overview of Proposals in NPR

As described above, the Commission concluded that the system of regulating rates and classes for Market Dominant products did not achieve the objectives of the PAEA, taking into account the factors. *See generally id.* The NPR set forth various proposals flowing from the Commission’s review of the ratemaking system. These

proposals addressed issues relating to the structure of the ratemaking system, specifically pricing efficiency, the financial health of the Postal Service (specifically, financial stability and operational efficiency), and service. In the NPR, the discussion of the proposals was organized according to the order in which they would appear in the revised regulations, as opposed to organized topically by the Commission's review of the ratemaking system in Order No. 4257.

With respect to the Postal Service's financial health and service, the proposals in the NPR set forth rules that provided mechanisms for additional rate authority including supplemental rate authority, performance-based rate authority, and rate authority for non-compensatory classes.¹⁴ To address the findings related to the system's failure to provide for the financial health of the Postal Service, the Commission proposed solutions intended to address the failure to attain medium-term and long-term financial stability. See *id.* at 27-73. These regulatory proposals were "aimed to put the Postal Service on the path to financial stability." *Id.* at 28. The Commission also provided additional background material to provide context and support to the proposals related to improving the financial health of the Postal Service. *Id.* at 27.

First, the Commission proposed a mechanism for supplemental rate authority to address the Postal Service's failure to maintain financial stability in the medium term. Under this proposed supplemental rate authority, the Postal Service would be allocated an additional 2 percentage points of rate authority per calendar year for the first 5 full calendar years following the effective date of the regulations. Order No. 4258 at 26. The proposed supplemental rate authority was aimed at putting the "Postal Service on the path to medium-term financial stability by providing the Postal Service the opportunity to generate additional revenue to cover its obligations." *Id.* at 38. The

¹⁴ See Order No. 4258 at 39-87. The Commission found additional rate authority alone was insufficient to address the need to increase operational efficiency and maintain high quality service standards. *Id.* at 55. The Commission's proposed performance-based rate authority therefore included mechanisms designed to address operational efficiency and service.

reference point for the proposed amount of supplemental rate authority was the \$2.7 billion net loss in FY 2017. *Id.*

Second, the Commission proposed a performance-based rate authority mechanism to provide up to an additional 1 percentage point of rate authority per calendar year to address the failure to maintain financial stability in the long term. *Id.* at 39. This proposal was dependent on the Postal Service achieving specific performance-based requirements for operational efficiency and service quality and was aimed at putting the “Postal Service on the path to long-term financial stability by providing the Postal Service the opportunity to generate retained earnings.” *Id.* at 38-39. The proposed amount of performance-based rate authority was based on “several reference points related to capital investment, capital assets, and borrowing authority.” *Id.* at 39. In addition to placing the Postal Service on the path to long-term financial stability, the proposal was aimed at remedying the deficiencies of the system with respect to the failure to maximize incentives to reduce costs and increase efficiency and maintain high quality service standards. *Id.* at 46.

To round out the proposed solutions related to the financial health of the Postal Service, the Commission also proposed a mechanism to improve the cost coverage of non-Compensatory classes and products by including rate design requirements for non-compensatory products and authorizing an additional 2 percentage points of rate authority per calendar year for non-compensatory classes of mail. *Id.* at 77. The proposal was based on the finding that non-compensatory classes and products threatened the financial integrity of the Postal Service because the revenues from these products and classes do not cover their attributable costs. *Id.* at 73; Order No. 4257 at 233-235. The proposal was aimed at placing the “Postal Service on the path to having fully compensatory products and classes.” Order No. 4258 at 73-74.

With respect to the finding that the system did not achieve pricing efficiency relating to the structure of the ratemaking system, the Commission proposed rules to

modify the requirements related to workshare discounts. The proposed rules phased out two practices that harm pricing efficiency: “workshare discounts set substantially below avoided costs and workshare discounts set substantially above avoided costs.” *Id.* at 93. The proposal was based on the finding that the system failed to produce efficient workshare discounts and was intended to “promote ECP and help the ratemaking system to maximize incentives to increase efficiency[.]” *Id.*

Finally, the NPR proposed additional procedural improvements intended to “improve the ratemaking process relating to planned rate adjustments of general applicability.” *Id.* at 98. These proposals were “within the scope of the Commission’s general authority to revise its regulations” and were in line with the Commission’s review in Order No. 4257 and comments received. *Id.* The proposed changes related to the schedule for regular and predictable rate adjustments and the timing for the notice period and related filings for rate adjustments. *Id.* at 98-99.

C. Overview of Proposals in Revised NPR

In response to the NPR, the Commission received and considered comments that reflect widely divergent views on all aspects of the proposed modifications to the ratemaking system. The comments discussed the legal authority for the Commission’s proposed modifications to the ratemaking system, the general framework of the Commission’s proposed rules, as well as specific comments regarding each proposal.

In this Revised NPR, the Commission proposes modified rules in consideration of the comments that are intended to result in a more robust system of ratemaking. An important component of the proposed rules is to ensure that modifications to the system of ratemaking provide the Postal Service with the ability to meet the objectives of section 3622. As described in Order No. 4257, the Commission determined that “while some aspects of the system of regulating rates and classes for market dominant products have worked as planned, overall, the system has not achieved the objectives

of the PAEA.” Order No. 4257 at 5. In Order No. 4257, the Commission determined that “the operating environment on which the PAEA was designed changed quickly and dramatically after the PAEA was passed[]” and that “this made it challenging for the ratemaking system under PAEA to achieve the goals it was designed to achieve.” *Id.* at 45.

As summarized above, the Commission set forth proposals addressing the failures of the ratemaking system with respect to the structure of the ratemaking process, the financial health of the Postal Service, and service. Certain Commission proposals in the NPR addressed multiple failings of the ratemaking system (*e.g.*, performance-based rate authority was intended to place the Postal Service on the path to long-term financial stability while maximizing incentives to increase operational efficiency and maintaining high quality service), while others had a singular focus (*e.g.*, worksharing was intended to resolve pricing efficiency issues). The modified proposals in this Revised NPR aim to strengthen and improve the initial proposals. Most notably, with regard to the supplemental authority, the modifications focus on the changes in the Postal Service’s operating environment and impacts that affect the ratemaking system. The Revised NPR approach is intended to provide a dynamic and responsive system consistent with the section 3622 objectives.

After consideration of comments and further analysis, including further consideration of potential inadequacies in the ratemaking system that impeded achievement of the objectives, the Commission provides revisions to its proposed rules in this Revised NPR. The majority of the modifications focus on the mechanism for the supplemental rate authority, with additional modifications to the performance-based rate authority and other proposals as summarized below and explained in further detail throughout this Revised NPR. The revised proposals place the Postal Service on the path to achieving the objectives by remedying the deficiencies of the ratemaking system and addressing the underlying causes of the failure to achieve the objectives. The

proposed changes are intended to create a solution, which reflects the reality of the ever-changing postal environment and economic conditions that impact the Postal Service and its users. Accordingly, the Commission summarizes the modified and new proposed rules in this Revised NPR below and describes each proposal in more detailed sections to follow.

First, in this Revised NPR, the Commission modifies the proposed supplemental rate authority mechanism to address drivers of the Postal Service's inability to achieve net income during the PAEA era. The Commission agrees with commenter concerns over the use of a single year's (FY 2017) net loss as an appropriate reference point for the supplemental rate authority and contentions that this additional rate authority was not tied to specific drivers of the Postal Service's losses. Some commenters and their expert witnesses endorse the use of separate rate design elements (often called "X-," "Y-," or "Z-" factors) to modify the price cap and address issues such as cost drivers that are exogenous to the Postal Service, noting that this approach has been adopted for other regulated industries.

After considering these comments, instead of a singular mechanism for supplemental rate authority based on a fixed amount, the revised supplemental rate authority proposal includes two separate mechanisms intended to provide rate authority to address costs that are outside of the Postal Service's control. The Commission proposes mechanisms to provide additional rate authority to: (1) address density declines¹⁵ and (2) allow the Postal Service to meet its retirement amortization payments. The mechanism to address density declines is dynamic and meant to remain in the system as needed to address changes in density. The mechanism for providing additional rate authority based on retirement amortization payments only remains in the system until such time as the Postal Service has sufficient revenue

¹⁵ In this context, density is defined as volume divided by delivery points.

incorporated into the rate base to cover those payments. These modified proposals are intended to go beyond the initial supplemental rate authority's goal of placing the Postal Service on the path to medium-term financial stability by providing the mechanisms necessary for the system to adjust appropriately to changes in the operating environment that are driving the Postal Service's net losses.

As discussed in both Order No. 4257 and Order No. 4258, the ongoing changes in the operating environment after the PAEA's enactment, including the economic downturn, the aggressive annual \$5.6 billion RHBF payment obligation, and technological trends, negatively impacted the Postal Service's financial health.¹⁶ These changes were largely outside of the Postal Service's control and are some of the significant drivers of the Postal Service's net losses. The Commission has identified the original system's inability to adapt and respond to these changes as a major contributor to the Postal Service's inability to meet the objectives of the PAEA. Therefore, an important component of these revised rules is the ability for the modified system to adapt to changes and impacts that hampered the system's ability to meet the objectives of the PAEA.

Next, the Commission modifies the proposed performance-based rate authority in order to better reflect the Commission's continued determination that the "lack of financial stability, insufficient levels of efficiency gains and cost reductions, and inability to adequately encourage the maintenance of service standard quality were interrelated causes and effects of the deficiencies experienced under the existing ratemaking system." Order No. 4258 at 52-53. The Commission considered a diverse set of comments regarding distinct aspects of the performance-based rate authority, including the overall intent of the proposal to address financial health (via long-term financial stability and operational efficiency) and service. The revised performance-based rate

¹⁶ See Order No. 4257 at 37-40, 148; Order No. 4258 at 27-39.

authority proposal retains the 1 percentage point of rate authority benchmark but modifies how the specific performance-based requirements for operational efficiency and service will be measured. These modifications are intended to allow the Postal Service to reenter the financial health cycle and provide a mechanism for the Postal Service to achieve long-term financial stability and increase operational efficiency while maintaining high quality service standards.

The Commission makes minor revisions to the proposal for non-compensatory products and revises the mechanism for rate adjustments for non-compensatory classes based on its consideration of the comments. The revised rules for non-compensatory classes and products propose that the use of the additional 2 percentage points of rate authority for non-compensatory classes be optional and remove the procedural requirement that determinations be made in the ACD proceeding. These modifications are intended to place the Postal Service on the path to having fully compensatory products and classes and improve the financial integrity of the system while allowing for the continued achievement of objectives relating to pricing flexibility, pricing efficiency, and establishing and maintaining reasonable rates.

For worksharing, the Commission revises its approach in response to commenter concerns with the passthrough bands and other issues. The revised rules for workshare discounts dispense with the 3-year grace period. The revisions separately address workshare discounts set below avoided costs and workshare discounts set above avoided costs in order to encourage steady improvement in pricing efficiency. The revised approach prohibits workshare discounts set equal to avoided cost from being changed, prohibits workshare discounts set below avoided cost from being reduced, and prohibits workshare discounts set above avoided cost from being increased. The modifications also add a new requirement that the Postal Service provide information and analysis specific to certain workshare discounts that are set excessively above or below avoided cost. These modifications are intended to

incentivize workshare discounts that adhere as closely as possible to ECP principles in order to help the ratemaking system maximize incentives to increase efficiency.

In this Revised NPR, the Commission proposes new reporting requirements for costs and cost-reduction initiatives in response to commenter concerns and in light of the revised proposals for additional rate authority. The proposals set forth reporting requirements for changes in unit costs, specific cost-reduction initiatives, and Decision Analysis Reports (DARs). The new cost reporting requirements focus on addressing issues relating to the structure of the ratemaking system, specifically the transparency of the system, and the financial health of the Postal Service by holding the Postal Service accountable for reporting on its efforts to reduce costs within its control.

In addition to the revised proposals and new cost reporting requirements as summarized above, the Commission proposes minor revisions that retain the substance and structure of the proposed rules. These procedural rules are intended to improve the ratemaking process relating to planned rate adjustments of general applicability.

Although this section provides an overview of the proposals to follow in this Revised NPR, the Commission discusses each proposal in more detail below. First, the Commission discusses and responds to comments on its legal authority for its proposals in this rulemaking and then provides revised proposals for its supplemental rate authority (comprised of both density rate authority and retirement obligation-based rate authority), performance-based rate authority, non-compensatory rate authority, workshare discounts, cost reductions, procedural improvements, and a review of the new proposed system 5 years after implementation.

III. REVIEW OF COMMENTS CONCERNING STATUTORY AUTHORITY

A. Introduction

Section 3622 of title 39 of the United States Code established a system to regulate the rates and classes of Market Dominant postal products. In order to put this system into operation, subsection (a) required the Commission to complete the initial setup within 18 months of the PAEA's enactment, and it allows for periodic adjustments to be made thereafter. In taking regulatory action pursuant to subsection (a), the Commission must apply 9 statutory objectives in conjunction with one another, and must also consider 14 statutory factors. 39 U.S.C. § 3622(a)(b)(c). Paragraphs (d)(1) and (d)(2) set forth specific parameters for the Commission's implementation of the system, including an annual limitation on the percentage change in rates for each mail class set equal to the annual percentage change in the consumer price index for all urban consumers (the CPI-U price cap). Subsection (e) codifies the basic parameters which had been developed by the former Postal Rate Commission to ensure that workshare discounts do not violate the ECP principle by offering too great a discount.¹⁷ Subsection (f) allowed the Postal Service, within 1 year of the PAEA's enactment, to initiate a final rate proceeding in accordance with the pre-PAEA ratemaking system.

Paragraph (d)(3) of section 3622 requires the Commission to conduct a review of the Market Dominant ratemaking system 10 years after the PAEA's enactment. The purpose of the review is to determine whether the system is achieving the objectives appearing in subsection (b), taking into account the factors appearing in subsection (c). If, upon completion of the mandatory 10-year review, including an opportunity for notice

¹⁷ The Postal Rate Commission was the predecessor agency to the Postal Regulatory Commission. *Compare* Postal Reorganization Act (PRA), Pub. L. No. 91-375, § 3601, 84 Stat. 719, 759 (1970), *with* PAEA, Pub. L. No. 109-435, § 601, 120 Stat. 3198, 3238 (2006) (codified at 39 U.S.C. § 501). Under ECP, discounts for worksharing activity are set equal to the cost avoided by the Postal Service. See, e.g., Docket No. RM2010-13, Order Resolving Technical Issues Concerning the Calculation of Workshare Discounts, April 20, 2012, at 3 (Order No. 1320).

and public comment, the Commission determines that the system is not achieving the objectives (taking into account the factors), then specific statutory authority on the Commission's part is triggered. Paragraph (d)(3) grants the Commission discretion to "by regulation, make such modification or adopt such alternative system for regulating rates and classes for market-dominant products as necessary to achieve the objectives." 39 U.S.C. § 3622(d)(3). This specific authority expands on the Commission's standing authority to revise the existing ratemaking system pursuant to subsection (a). Additionally, the Commission has general authority to promulgate rules and regulations, establish procedures, and take any other action deemed necessary and proper to carry out its functions and obligations, as prescribed under title 39 of the United States Code. 39 U.S.C. § 503.

Order No. 4258 addressed comments positing that the Commission lacks statutory authority to modify or replace the CPI-U price cap. Order No. 4258 at 11-25. The Commission analyzed the three primary arguments raised by commenters in support of this position: (1) that the plain language of section 3622 clearly forecloses modification or replacement of the CPI-U price cap; (2) that modification or replacement of the CPI-U price cap would be inconsistent with the PAEA's legislative history; and (3) that modification or replacement of the CPI-U price cap would produce unconstitutional results. *Id.* The Commission also addressed comments objecting to the inclusion of workshare discounts as an issue in this proceeding. *Id.* at 18-19, 25. The Commission has concluded that its authority is broad enough to allow for the modification or replacement of all aspects of the existing Market Dominant ratemaking system, if necessary to achieve the objectives appearing in section 3622(b). *Id.* at 19. This includes making additional rate adjustment authority available to the Postal Service, as well as limiting the setting of inefficient workshare discounts. *Id.* at 25.

B. Comments

1. Introduction

The comments received in response to Order No. 4258 that discuss the Commission's statutory authority focus largely on the Commission's proposal to make additional rate adjustment authority available to the Postal Service. Comments were also received concerning the statutory authority underlying the Commission's proposal to limit the setting of inefficient workshare discounts. Many of the comments received in response to Order No. 4258 echo prior remarks submitted in this proceeding.¹⁸

2. Additional Rate Adjustment Authority

In discussing the Commission's proposal to make additional rate adjustment authority available to the Postal Service, multiple commenters restate their prior view as to whether the Commission has the statutory authority to modify or adopt an alternative

¹⁸ For example, 2 years prior to the institution of this proceeding, eight entities submitted a joint white paper to the Commission stating their view that the Commission lacked statutory authority to rescind or substantially modify the CPI-U price cap under paragraph (d)(3). Alliance of Nonprofit Mailers; Association for Postal Commerce; Association of Marketing Service Providers; Direct Marketing Association; EMA; MPA—the Association of Magazine Media; National Association of Advertising Distributors, Inc.; and Saturation Mailers Coalition, *Limitations on the Commission's Authority Under Section 3622(d)(3)*, October 28, 2014 (2014 ANM *et al.* White Paper). The joint comments submitted by three of those entities in response to Order No. 3673 referenced this document. See Order No. 3673; Comments of Alliance of Nonprofit Mailers, Association for Postal Commerce, and MPA—the Association of Magazine Media, March 20, 2017, at 9-10 n.2 (2017 ANM *et al.* Comments). The joint comments submitted by the same three entities (and two additional entities) in response to Order No. 4258 cite to the 2014 ANM *et al.* White Paper at Appendix A. Comments of Alliance of Nonprofit Mailers, American Catalog Mailers Association, Inc., Association for Postal Commerce, Idealliance and MPA—the Association of Magazine Media, March 7, 2018, Appendix A (ANM *et al.* Comments); see Errata Notice of Alliance of Nonprofit Mailers, American Catalog Mailers Association, Inc., Association for Postal Commerce, Idealliance and MPA—the Association of Magazine Media, March 5, 2018.

Multiple other commenters also renew lines of argument originally advanced during the first round of comments in this docket in 2017, including ABA, MMA *et al.*, and the Greeting Card Association (GCA). See Order No. 4258 at 6-25 (citing Comments of American Bankers Association, March 20, 2017, at 8-10 (2017 ABA Comments); Comments of the Major Mailers Association, the National Association of Presort Mailers, and the National Postal Policy Council, March 20, 2017, at 12-17; Initial Comments of the Greeting Card Association, March 20, 2017, at 29-34 (2017 GCA Comments)).

to the CPI-U price cap. Commenters ABA, ACI, Alliance of Nonprofit Mailers, American Catalog Mailers Association, Inc., Association for Postal Commerce, Idealliance, and MPA—the Association of Magazine Media (ANM *et al.*), GCA, and the National Postal Policy Council, the Major Mailers Association, and the National Association of Presort Mailers (NPPC *et al.*) posit that the PAEA does not authorize the provision of additional rate adjustment authority.¹⁹ On the other hand, the American Postal Workers Union, AFL-CIO (APWU), the National Postal Mail Handlers Union (NPMHU), the Postal Service, the Public Representative, and UPMA all counter that section 3622(d)(3) provides broad authority for the Commission to permit rate adjustments in excess of CPI-U.²⁰ The Commission summarizes the discussion provided by ABA, ANM *et al.*, and NPPC *et al.*, as well as the responses provided by the Postal Service and the Public Representative.²¹

¹⁹ Comments of American Bankers Association, March 1, 2018, at 4-6 (ABA Comments); Comments of American Consumer Institute Center for Citizen Research Regarding Docket No. RM2017-3, February 23, 2018, at 1 (ACI Comments); ANM *et al.* Comments at 9-29; Initial Comments of the Greeting Card Association, March 1, 2018, at 1 (GCA Comments) (citing 2017 GCA Comments at 29-34); Comments of the National Postal Policy Council, the Major Mailers Association, and the National Association of Presort Mailers, March 1, 2018, at 19-40 (NPPC *et al.* Comments).

²⁰ Reply Comments of the American Postal Workers Union, AFL-CIO on the Notice of Proposed Rulemaking for the System for Regulating Rates and Classes for Market Dominant Products, March 30, 2018, at 2-3 (APWU Reply Comments); Comments of the National Postal Mail Handlers Union, March 1, 2018, at 2 (NPMHU Comments); Initial Comments of the United States Postal Service in Response to Order No. 4258, March 1, 2018, at 11-12 (Postal Service Comments); Comments of the United Postmasters and Managers of America, February 28, 2018, at 4; Initial Comments of the Public Representative, March 1, 2018, at 8 (refiled March 7, 2018) (PR Comments); see also Errata Notice of the Public Representative, March 7, 2018.

²¹ The Commission focuses on these three commenters in particular because their comments contain detailed discussions on the issue of statutory authority.

a. Discussion by ABA, ANM *et al.*, and NPPC *et al.*

ABA, ANM *et al.*, and NPPC *et al.* assert that the Commission's proposal to make additional rate adjustment authority available to the Postal Service contravenes the plain language of the PAEA.²² Echoing prior remarks filed in this proceeding, these commenters contend that use of the word "shall" in paragraph (d)(1) of section 3622 unambiguously forecloses the Commission from adopting a system that would allow the Postal Service to adjust rates by more than the annual percentage change in CPI-U.²³ These commenters maintain their focus on the word "system," relying on the presumption that the word's usage throughout the PAEA implies that it has the same meaning in each instance.²⁴ These commenters also contend that the lack of qualifiers on the word "system" (such as, *e.g.*, "the first system," "the initial system," "the system preceding the 10 year review," or "notwithstanding the requirements of § 3622(d)"), demonstrates that Congress intended for the CPI-U price cap to apply to *all* possible iterations of the ratemaking system.²⁵

²² ABA Comments at 4-6; ANM *et al.* Comments at 10-28; NPPC Comments at 19-27.

²³ ABA Comments at 5; ANM *et al.* Comments at 11; NPPC *et al.* Comments at 20-22; see 2017 ABA Comments at 8-9; 2014 ANM *et al.* White Paper at 6-7.

²⁴ ABA Comments at 5; ANM *et al.* Comments at 13; NPPC *et al.* Comments at 23; see 2017 ABA Comments at 8-10; 2014 ANM *et al.* White Paper at 10.

²⁵ ABA Comments at 5; ANM *et al.* Comments at 23 n.8, 24; NPPC *et al.* Comments at 25; see 2017 ABA Comments at 9.

The interpretation of section 3622 urged by ANM *et al.* and NPPC *et al.* posits that paragraph (d)(3) only authorizes the Commission to adopt rules which implement the statutory provisions appearing in paragraphs (d)(1) and (d)(2), including the CPI-U price cap.²⁶ More specifically, ANM *et al.* and NPPC *et al.* interpret the textual parallelism between subsection (a) and paragraph (d)(3) to mean that the Commission's authority to modify or replace regulations under paragraph (d)(3) mirrors the Commission's authority to establish implementing regulations under subsection (a).²⁷ The American Bankers Association (ABA) similarly asserts that "Congress instructed the Commission to review the system the *Commission* created, not the limitations on that system *Congress* created." 2017 ABA Comments at 9 (emphasis in original).

ANM *et al.* assert that the Commission relies on a flawed reading of the words "establish" and "revise," which appear in subsection (a), in relation to the phrase "make such modification or adopt such alternative system," which appears in paragraph (d)(3). ANM *et al.* Comments at 16-17. ANM *et al.* describe "revise" and "modify" as being synonymous. *Id.* at 17. ANM *et al.* construe "adopting an 'alternative' system" as a way to 'revise' or 'modify' the original system." *Id.*

²⁶ ANM *et al.* Comments at 2, 12-13; NPPC *et al.* Comments at 19.

²⁷ ANM *et al.* Comments at 12-13; NPPC *et al.* Comments at 23-24; see 2014 ANM *et al.* White Paper at 11. NPPC *et al.* argue that this result can be seen in Congress's use of the words "established" and "under" in paragraph (d)(3). NPPC *et al.* Comments at 23-24. Specifically, paragraph (d)(3) states that the Commission "shall review the system for regulating rates and classes for market-dominant products *established under* this section...." 39 U.S.C. § 3622(d)(3) (emphasis added). NPPC *et al.* maintain that "[i]f Congress intended the Commission's review authority to allow it to override the mandatory provisions of Section 3622(d)(1), one would have expected Congress to have written 39 U.S.C. § 3622(d)(3) to authorize the Commission to review the system '*created by* this section.'" NPPC *et al.* Comments at 24 (emphasis in original).

ANM *et al.* also state that “even if there were a meaningful difference between the option to ‘make...modification to’ and the option to ‘adopt [an] alternative system,’ neither option would allow the Commission to ignore the ‘Requirements’ of Section 3622(d).” *Id.* ANM *et al.* interpret the statutory objectives appearing in subsection (b) to be subordinate to the requirements of subsection (d). *Id.* at 18. ANM *et al.* assert that it is not necessary for paragraph (d)(3) to contain a textual modifier restricting the scope of the “alternative system” which the Commission may adopt, because the relevant restrictions appear in paragraphs (d)(1) and (d)(2). *Id.* at 21, 23.

NPPC *et al.* contend that if Congress had intended to enact a sunset date on the CPI-U price cap, then Congress would have done so explicitly, just as it explicitly stated the other limitations in paragraph (d)(2). NPPC *et al.* Comments at 25-26. NPPC *et al.* cite the general legal principle that “[w]here Congress explicitly enumerates certain exceptions to a general prohibition, additional exceptions are not to be implied.”²⁸ NPPC *et al.* maintain that the failure to have done so indicates that Congress intended for the CPI-U price cap to apply to any rate structure created by the Commission. *Id.* at 25-26. NPPC *et al.* assert that the title of subsection (d)—“Requirements”—is consistent with their interpretation of the mandatory nature of the CPI-U price cap.²⁹ NPPC *et al.* contend that the Commission improperly dismissed this interpretation. NPPC *et al.* Comments at 22-23.

²⁸ *Id.* at 26 (citing *Andrus v. Glover Constr. Co.*, 446 U.S. 608, 616-617 (1980)).

²⁹ *Id.* at 22-23; see also ANM *et al.* Comments at 11 (“The ‘Requirements’ of the system of ratemaking are, indeed, required elements of the system of ratemaking.”).

ANM *et al.* and NPPC *et al.* submit that paragraph (d)(3) was included in section 3622 to require the Commission to reassess the performance of its implementing regulations with regard to the CPI-U price cap.³⁰ ANM *et al.* and NPPC *et al.* maintain that their interpretation of paragraph (d)(3) does not render it mere surplusage or an empty formality, because there are a number of options that the Commission could take while still retaining the CPI-U price cap.³¹ NPPC *et al.*, in particular, assert that:

There are numerous actions that the Commission might have proposed in this review, including: using a Passche [i]index instead of a [Laspeyres index]; changing how it calculates CPI increases; modify[ing] the cap to subtract for periods of deflation; adopt[ing] an X-Factor to increase the incentive for cost reduction; modify[ing] the rules for below-cost products; defin[ing] more products and price points within classes and products; or us[ing] a quality-of-service adjusted price cap.

NPPC *et al.* Comments at 27 n.23. On this basis, these commenters maintain that their interpretations would not reduce the 10-year review and any resulting rulemaking to an empty formality.³²

ABA, ANM *et al.*, and NPPC *et al.* assert that the PAEA unambiguously precludes the Commission from making additional rate adjustment authority available to

³⁰ ANM *et al.* Comments at 19; NPPC *et al.* Comments at 27.

³¹ ANM *et al.* Comments at 19 n.6 (citing Docket No. RM2007-1, Second Advance Notice of Proposed Rulemaking on Regulations Establishing a System of Ratemaking, May 17, 2007, at 2-5 (Order No. 15); Docket No. RM2007-1, Order Proposing Regulations to Establish a System of Ratemaking, August 15, 2007 (Order No. 26); Docket No. RM2007-1, Order Establishing Ratemaking Regulations for Market Dominant and Competitive Products, October 29, 2007 (Order No. 43); Docket No. RM2009-8, Order Amending the Cap Calculation in the System of Ratemaking, September 22, 2009 (Order No. 303); Docket No. RM2013-2, Order Adopting Final Rules for Determining and Applying the Maximum Amount of Rate Adjustments, July 23, 2013 (Order No. 1786); Docket No. RM2014-3, Order Adopting Final Rules on the Treatment of Rate Incentives and De Minimis Rate Increases for Price Cap Purposes, June 3, 2014 (Order No. 2086); Docket No. RM2016-6, Order Adopting Final Procedural Rule for Mail Preparation Changes, January 25, 2018 (Order No. 4393)); NPPC *et al.* Comments at 27 n.23.

³² ANM *et al.* Comments at 19 n.6; NPPC *et al.* Comments at 27.

the Postal Service.³³ Therefore, ANM *et al.* contend that a reviewing court would resolve this question in their favor under *Chevron* step one.³⁴

Because it is their position that the text of the PAEA clearly forecloses the Commission from adopting its proposal, ABA, ANM *et al.*, and NPPC *et al.* contend that there is no need to look to the PAEA's legislative history.³⁵ With regard to the floor statement of Senator Susan Collins that the Commission discussed in Order No. 4258, they argue that it is not an authoritative interpretation of the PAEA.³⁶ These commenters observe that unlike a committee report, Senator Collins' statement represents the remarks of a single legislator.³⁷ NPPC *et al.* further assert that Senator Collins' statement is inconsistent with the longstanding role of Congress in managing the postal system. NPPC *et al.* Comments at 29-30. In response to the Commission's finding in Order No. 4258 that paragraph (d)(3) was the result of a legislative compromise, ANM *et al.* counter that the legislative compromise "could well have been to require the Commission to review the operation of the rate system after 10 years and evaluate how to modify it to improve performance while still retaining the CPI-based limitation."³⁸ For this reason, ANM *et al.* also assert that any ambiguity in the PAEA would be resolved in their favor under *Chevron* step two. See ANM *et al.* Comments at 17 n.4.

³³ See ABA Comments at 6; ANM *et al.* Comments at 11, 22, 24; NPPC *et al.* Comments at 28.

³⁴ See ANM *et al.* Comments at 17 n.4. Federal courts review an agency's interpretation of its governing statute under the two-step framework from *Chevron U.S.A. Inc. v. Nat. Resources Def. Council, Inc.* ("*Chevron*"), 467 U.S. 837 (1984).

³⁵ ABA Comments at 6; ANM *et al.* Comments at 24, 26; NPPC *et al.* Comments at 28.

³⁶ 152 Cong. Rec. S11674, S11675 (daily ed. Dec. 8, 2006) (statement of Sen. Collins); ABA Comments at 6; ANM *et al.* Comments at 25-26; NPPC *et al.* Comments at 28; see Order No. 4258 at 22-23.

³⁷ ABA Comments at 6; ANM *et al.* Comments at 25-26; NPPC *et al.* Comments at 28.

³⁸ ANM *et al.* Comments at 25; see Order No. 4258 at 20-23.

Additionally, ABA, ANM *et al.*, and NPPC *et al.* cite prior Commission orders, which purportedly corroborate their interpretation that the qualitative pricing standards (such as the statutory objectives and factors) are subordinate to the quantitative pricing standards (such as the CPI-U price cap) in the hierarchy established by the PAEA.³⁹ These commenters assert that the statutory interpretation of paragraph (d)(3) put forth in Order No. 4258 is inconsistent with these prior rulings.⁴⁰ ANM *et al.* dismiss Order No. 4258's analysis distinguishing these prior statements, characterizing it as "a distinction without a difference."⁴¹ ABA and ANM *et al.* assert that the Commission has failed to provide a reasoned basis for departing from its prior rulings.⁴²

Finally, ANM *et al.* and NPPC *et al.* argue that the Commission's interpretation of paragraph (d)(3) produces unconstitutional results.⁴³ First, ANM *et al.* and NPPC *et al.* assert that the Commission's interpretation would violate the Constitution's Presentment Clause.⁴⁴ These commenters maintain that the Commission's interpretation would produce a result similar to that of the Line Item Veto Act, which was found to be impermissible by the Supreme Court in *Clinton v. City of New York*, 524 U.S. 417

³⁹ ABA Comments at 5-6; ANM *et al.* Comments at 13-15, 18, 27-29 (citing Order No. 26); Docket No. RM2009-3, Order Adopting Analytical Principles Regarding Workshare Discount Methodology, September 14, 2010 (Order No. 536); Docket No. R2010-4, Order Denying Request for Exigent Rate Adjustments, September 30, 2010 (Order No. 547); Docket No. R2010-4R, Order Resolving Issues on Remand, September 20, 2011 (Order No. 864); Docket No. ACR2010-R, Order on Remand, August 9, 2012 (Order No. 1427)); NPPC *et al.* Comments at 26 (citing Order No. 536; Docket No. ACR2010, *Annual Compliance Determination*, March 29, 2011, at 18-19 (FY 2010 ACD)); see 2014 ANM *et al.* White Paper at 5-6, 12-15 (citing Order No. 536; Order No. 547).

⁴⁰ ABA Comments at 5-6; ANM *et al.* Comments at 13-15, 18, 27-29; NPPC *et al.* Comments at 26-27.

⁴¹ ANM *et al.* Comments at 28; see Order No. 4258 at 18.

⁴² ABA Comments at 5-6; ANM *et al.* Comments at 27-29.

⁴³ ANM *et al.* Comments at 18 n.5; NPPC *et al.* Comments at 31-40.

⁴⁴ ANM *et al.* Comments at 18 n.5; NPPC *et al.* Comments at 31-35.

(1998).⁴⁵ NPPC *et al.* concede that Congress may authorize the executive branch to waive the application of statutory provisions in specified circumstances.⁴⁶ However, they argue that such an authorization must be expressly stated, and “Congress itself [must have] made the decision to suspend or repeal the particular provisions at issue upon the occurrence of particular events subsequent to enactment, and...only left the determination of whether such events occurred up to [the executive branch].” *Id.* at 33. NPPC *et al.* maintain that the PAEA’s statutory objectives and factors do not provide the required direction for purposes of the Presentment Clause, because while “[t]hey require the Commission to take action in ten years...and to review various policy considerations when they take that action...they don’t cabin the bottom line at all....” *Id.* at 34-35. Specifically, “[t]hey don’t specify the ‘particular events’ that would call for the Commission to act; or instruct the Commission on how to act when those events occur.” *Id.* Thus, NPPC *et al.* maintain, the statutory objectives and factors “are simply a set of policy considerations that do not, on their own, come close to providing the level of legislative direction that the Presentment Clause demands.” *Id.* at 35. The result of the Commission’s interpretation of paragraph (d)(3), according to NPPC *et al.*, would be the Commission “substitut[ing] its policy decisions for those of Congress.” *Id.* at 32.

Second, NPPC *et al.* assert that the Commission’s interpretation of paragraph (d)(3) would violate the Constitution’s non-delegation doctrine, under which Congress may only confer decision-making authority upon an agency where it lays down an “intelligible principle” to guide the agency’s discretion.⁴⁷ NPPC *et al.* contend that the PAEA’s objectives and factors are too general and vague to provide limitations on the Commission’s authority that would be sufficient to satisfy this doctrine. *Id.* at 37-39.

⁴⁵ ANM *et al.* Comments at 18 n.5; NPPC *et al.* Comments at 32-35.

⁴⁶ NPPC *et al.* Comments at 32-33 (citing *Republic of Iraq v. Beatty*, 556 U.S. 848, 861 (2009); *Marshall Field & Co. v. Clark*, 143 U.S. 649, 693 (1892); *Clinton*, 524 U.S. at 445).

⁴⁷ *Id.* at 35-40 (citing *Whitman v. Am. Trucking Ass’ns, Inc.*, 531 U.S. 457, 472 (2001)).

With respect to the non-delegation argument, NPPC *et al.* argue that “[o]nce the price cap and limitations found in Sections 3622(d)(1) and (2) are removed, there would be no policy, no standard, and no rule,” because “[t]he [PAEA’s] objectives and factors...are nothing more than general aims and a broad range of objectives...amongst which the Commission is not required to choose.”⁴⁸

b. Responses by the Postal Service and the Public Representative

The Postal Service and the Public Representative reject the view that the Commission’s interpretation of paragraph (d)(3) of section 3622 contradicts the plain meaning of the PAEA.⁴⁹ Both maintain that the CPI-U price cap is included in the system subject to review and potential alteration or replacement under paragraph (d)(3).⁵⁰ The Postal Service asserts that the structural position of paragraph (d)(3)—as the final subparagraph of subsection (d)—should lead a reader to conclude that subparagraph (3) requires review of the general requirements and limitations appearing in subparagraphs (1) and (2), in addition to the regulations implemented and revised pursuant to subsection (a). Postal Service Reply Comments at 12.

The Postal Service and the Public Representative posit that any presumption that the word “system” has the same meaning in both subsection (a) and paragraph (d)(3) fails in this instance, because the words at issue in each respective provision are used in different contexts.⁵¹ The Postal Service argues that the general term “system,” as

⁴⁸ *Id.* at 37-38 (internal punctuation omitted) (citing *A.L.A. Schechter Poultry Corp. v. United States*, 295 U.S. 495 (1935); *Panama Refining Co. v. Ryan*, 293 U.S. 388 (1935)).

⁴⁹ Reply Comments of the United States Postal Service in Response to Order No. 4258, March 30, 2018, at 7-19 (Postal Service Reply Comments); Reply Comments of the Public Representative, March 30, 2019, at 7-9 (PR Reply Comments).

⁵⁰ Postal Service Comments at 12 n.16; Postal Service Reply Comments at 12; PR Reply Comments at 9.

⁵¹ Postal Service Reply Comments at 10-11; PR Reply Comments at 8.

used in paragraph (d)(3), can plausibly be read to refer to the overall framework for regulating Market Dominant rates, which encompasses both the PAEA's statutory provisions and the Commission's implementing regulations. Postal Service Reply Comments at 11. The Postal Service notes that this interpretation is consistent with dictionary definitions of "system." See *id.* at 12.

The Postal Service and the Public Representative both assert that because paragraph (d)(3) uses broader language than subsection (a), paragraph (d)(3) confers a broader degree of authority on the Commission than subsection (a) does.⁵² The Public Representative deems ANM *et al.*'s interpretation of the phrase "adopting an 'alternative' system" as a mere variant of "revise" or "modify" to be "unsatisfying."⁵³ The Postal Service points out that paragraph (d)(3) juxtaposes "modification" with a more fundamental type of change—an "alternative system." Postal Service Reply Comments at 14.

The Postal Service notes that the CPI-U price cap could remain in place for more than 10 years after the PAEA's enactment, if, for example, the Commission's review had determined that the current ratemaking system was achieving the PAEA's objectives. *Id.* at 18. Hence, according to the Postal Service, the lack of an explicit sunset provision in the statute for the CPI-U price cap is not dispositive with regard to the question of whether Congress intended for the CPI-U price cap to be permanent. *Id.*

The Postal Service and the Public Representative contend that reading paragraph (d)(3) as merely directing the Commission to review and alter its implementing regulations would render paragraph (d)(3) redundant with subsection

⁵² Postal Service Reply Comments at 13; PR Reply Comments at 8.

⁵³ PR Reply Comments at 9 (citing ANM *et al.* Comments at 17).

(a).⁵⁴ With regard to ANM *et al.* and NPPC *et al.*'s counterargument that subsection (a) permits the Commission to review its regulations on its own initiative, whereas paragraph (d)(3) requires a review of those regulations after 10 years, the Public Representative notes that this fails to explain either the textual differences in the respective provisions or the differing triggering conditions contained in them. PR Reply Comments at 8. He also observes that this explanation fails to explain why paragraph (d)(3) authorizes the Commission "to implement a remedy 'as necessary to achieve the objectives,'" without reference to the PAEA's other provisions (such as the CPI-U price cap). *Id.*

Emphasizing its agreement with the Commission that the PAEA unambiguously allows the Commission to replace the CPI-U price cap, the Postal Service asserts that the Commission's interpretation would be upheld by a federal court under *Chevron* step one. Postal Service Reply Comments at 9 n.10. In the alternative, the Postal Service asserts that "[a]t most the statute is ambiguous, and the Commission's interpretation is reasonable," and would therefore be upheld under *Chevron* step two. *Id.* The Public Representative maintains that ambiguities exist in the PAEA, and he disagrees that the issue would be resolved under *Chevron* step one. PR Reply Comments at 10-12. Instead, he argues that the Commission's interpretation is a permissible construction of a statutory ambiguity, and hence would be accorded deference under *Chevron* step two. *Id.*

The Postal Service asserts that to the extent that any ambiguity concerning the scope of an alternative system exists, the PAEA's legislative history confirms that the Commission is able to alter or eliminate the CPI-U price cap. Postal Service Reply Comments at 14-15. The Postal Service submits that the statement of Senator Collins, as the Senate sponsor of postal reform, should be accorded considerable weight. *Id.*

⁵⁴ Postal Service Comments at 12 n.16; PR Reply Comments at 8.

The Postal Service maintains that paragraph (d)(3) represented a compromise between the Senate version of the bill, which contained a permanent CPI-U price cap, and the House version of the bill, which would have granted the Commission the discretion to select the appropriate mode of regulation from the outset. Postal Service Comments at 12. The Postal Service asserts that the final compromise reached by Congress provided that the CPI-U price cap would remain in effect for 10 years, after which the Commission would have the discretion to modify or replace that system with an alternative system if it was not achieving the PAEA's statutory objectives. *Id.* The Postal Service characterizes this choice as consistent with the historical trend of Congress shifting discretion over postal matters to the executive branch, as well as the more general trend of Congress establishing initial regulatory frameworks but allowing regulatory agencies to amend those frameworks as circumstances change.⁵⁵

The Postal Service disagrees that Order No. 4258 represents an “unexplained departure” from any past position by the Commission with regard to its authority under paragraph (d)(3) or the policy value of the CPI-U price cap. Postal Service Reply Comments at 18-19. The Postal Service characterizes the prior Commission statements cited by the commenters as reflecting “Congress’s policy decision to impose the price cap in effect at the time,” rather than “a policy judgment about whether the same price cap would remain good policy in all circumstances going forward.” *Id.* at 19.

The Postal Service asserts that the commenters fail to rebut the Commission’s “reasoned rejection” of any constitutional concerns with regard to paragraph (d)(3). *Id.* at 8. Specifically with regard to the non-delegation doctrine, the Postal Service asserts

⁵⁵ *Id.* at 16-17. The Postal Service cites as examples the Federal Communication Commission’s (FCC’s) ability to amend its statutory fee schedule, as well as Congress’s requiring the Secretary of Transportation to prescribe standards regarding gas and hazardous liquid pipelines, while simultaneously enacting default risk-analysis and integrity-management requirements to apply to pipeline operators in the interim until the Secretary of Transportation’s rules could be promulgated. *Id.* at 17-18 (citing 47 U.S.C. § 159; 49 U.S.C. § 60109).

that NPPC *et al.* continue to base their arguments on two cases with limited precedential value. *Id.* The Postal Service points instead to more extensive and more recent case law upholding delegations to agencies based on intelligible principles. *Id.* at 8-9. The Postal Service argues that the PAEA's 9 statutory objectives and 14 statutory factors provide more-than-sufficient guidance to justify upholding the delegation in this case.⁵⁶

3. Workshare Discounts

GCA and the Postal Service restate their position that workshare discounts are not within the scope of this proceeding (that is, subject to neither review nor potential regulatory action).⁵⁷ The Postal Service also asserts that setting a passthrough floor is contrary to the language, structure, and objectives of section 3622. Postal Service Reply Comments at 108 n.285.

ANM *et al.*, NPPC *et al.*, and Pitney Bowes Inc. (Pitney Bowes) counter that the Commission's workshare discount proposal is within the Commission's legal authority.⁵⁸ ANM *et al.* assert that the Commission's rules implementing section 3622(e) and governing workshare discounts are part of the "system." ANM *et al.* Reply Comments at 73. ANM *et al.* state that the Commission's workshare discount proposal must comply

⁵⁶ Postal Service Comments at 12; Postal Service Reply Comments at 9. The Postal Service also asserts that "ultimately, NPPC *et al.*'s arguments are pointless[] since the Commission lacks jurisdiction to rule on the statute's constitutionality and cannot cure a constitutional defect through self-restraint." Postal Service Reply Comments at 9. Thus, "[t]he Commission's role is to...fulfill the statutory role that Congress clearly conferred on it...[and] [u]ltimately, it is [a] court's role to decide whether Congress's decision to confer that authority on the Commission is constitutional." *Id.* at 9 n.9.

⁵⁷ GCA Comments at 1 n.1 (citing 2017 GCA Comments at sections V-VI); Postal Service Reply Comments at 111 n.292 (citing Postal Service Comments at 146-147).

⁵⁸ Reply Comments of Alliance of Nonprofit Mailers, American Catalog Mailers Association, Inc., Association for Postal Commerce, Data & Marketing Association, Idealliance, and MPA—the Association of Magazine Media, March 30, 2018, at 73-74 (ANM *et al.* Reply Comments); Reply Comments of the National Postal Policy Council, the Major Mailers Association, and the National Association of Presort Mailers, March 30, 2018, at 5 (NPPC *et al.* Reply Comments); Comments of Pitney Bowes Inc., March 1, 2018, at 4-9 (Pitney Bowes Comments).

with section 3622(e) and that the Commission's proposal meets this standard. *Id.* at 73-74. Pitney Bowes asserts that section 3622(d)(3) mandates review of the system "established under this section," which refers to the entirety of section 3622, including the workshare discount provisions appearing in subsection (e). Pitney Bowes Comments at 5. Pitney Bowes contends that nothing in the PAEA prevents the Commission from establishing a floor (or a band applicable to passthroughs under 100 percent), as proposed by Order No. 4258. *Id.* at 6. Pitney Bowes adds that the Commission's proposal concerning passthroughs over 100 percent would implement the qualitative considerations appearing in 39 U.S.C. § 3622(e) into a quantitative range. *Id.* at 8.

C. Commission Analysis

1. Introduction

First, this Section addresses the positions of commenters asserting that the Commission lacks the statutory authority to make additional rate adjustment authority available to the Postal Service. This includes issues pertaining to the PAEA's text, structure, and legislative history, as well as arguments that the Commission's current interpretation of paragraph (d)(3) of section 3622 is inconsistent with prior Commission statements and arguments concerning the constitutionality of the Commission's interpretation of paragraph (d)(3). Second, this Section addresses issues that exclusively pertain to the Commission's statutory authority to limit the setting of inefficient workshare discounts.

2. Additional Rate Adjustment Authority

Federal courts evaluate an agency's interpretation of its governing statute using the two-step framework set forth in *Chevron*. Under *Chevron* step one, the court considers whether "Congress has directly spoken to the precise question at issue."

Chevron, 467 U.S. at 842. If so, “that is the end of the matter; for the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress.” *Id.* at 842-843. If not, then the court proceeds to *Chevron* step two and considers whether the agency’s interpretation “is based on a permissible construction of the statute.” *Id.* at 843. The court must defer to the agency’s interpretation if it is “reasonable.” *Id.* at 844.

a. The PAEA’s Plain Language

At *Chevron* step one, a court must “exhaust the traditional tools of statutory construction to determine whether Congress has spoken to the precise question at issue[.]...[which] include examination of the statute’s text, legislative history, and structure, as well as its purpose.”⁵⁹ To prevail under *Chevron* step one, a challenger “must do more than offer a reasonable or, even the best, interpretation [of the statute in question].”⁶⁰ “Instead, they ‘must show that the statute *unambiguously* forecloses the [agency’s] interpretation.’”⁶¹ “[T]hey must demonstrate that the challenged term is susceptible of only [one] possible interpretation.”⁶²

The plain language of paragraph (d)(3) of section 3622 contemplates the modification or replacement of the existing Market Dominant ratemaking system, if necessary to achieve the statutory objectives appearing in subsection (b). As an initial matter, the Commission notes that the nature of the proposal it is putting forward is a

⁵⁹ *Petit v. United States Dep’t of Educ.*, 675 F.3d 769, 781 (D.C. Cir. 2012) (quoting *Bell Atlantic Telephone Cos. v. FCC*, 131 F.3d 1044, 1047 (D.C. Cir. 1997)).

⁶⁰ *Petit*, 675 F.3d at 781 (quoting *Village of Barrington, Ill. v. Surface Transp. Bd.*, 636 F.3d 650, 661 (D.C. Cir. 2011)).

⁶¹ *Id.* (emphasis in original) (quoting *Village of Barrington*, 636 F.3d at 661).

⁶² *Petit*, 675 F.3d at 781 (quoting *County of Los Angeles v. Shalala*, 192 F.3d 1005, 1015 (D.C. Cir. 1999) (internal marks and citation omitted)); see also *Chevron*, 467 U.S. at 843 n.11 (“The court need not conclude that the agency construction was the only one it permissibly could have adopted to uphold the construction, or even the reading the court would have reached if the question initially had arisen in a judicial proceeding.” (citations omitted)).

modification. The Commission is proposing adjustments to the CPI-U price cap that are consistent with price cap theory.

Price cap formulas generally start with a measure of inflation (called the inflation factor), such as the CPI-U index.⁶³ Most price cap formulas also include various adjustments to the inflation factor.⁶⁴ When establishing 39 C.F.R. part 3010 in accordance with section 3622(a) in 2007, the Commission considered, but ultimately opted to defer, applying adjustment factors to the CPI-U index.⁶⁵ This approach allowed the Postal Service latitude to operate with minimal regulation under the new ratemaking system. See Order No. 26 at ¶¶ 2067-2068. However, based on the Commission's findings in Order No. 4257, the Commission has determined that adjustment factors are now necessary to remedy the existing ratemaking system's failure to meet the objectives. See Order No. 4257.

When promulgating the initial implementing regulations after enactment of the PAEA, the Commission stated that it would develop additional regulation if experience under the new system showed that additional regulation was necessary to achieve the

⁶³ See, e.g., United States Postal Service, Office of the Inspector General, Report No. RARC-WP-13-007, Revisiting the CPI-Only Price Cap Formula, April 12, 2013, at 46, available at: https://www.uspsoig.gov/sites/default/files/document-library-files/2015/rarc-wp-13-007_0.pdf (RARC-WP-13-007).

⁶⁴ For instance, most price cap formulas include an "X-factor" to offset productivity growth. See RARC-WP-13-007 at 45; United States Postal Service, Office of Inspector General, Risk Analysis Research Center, Report No. RARC-WP-17-003, Lessons in Price Regulation from International Posts, February 8, 2017, Appendix A at 16, available at: <https://www.uspsoig.gov/sites/default/files/document-library-files/2017/RARC-WP-17-003.pdf>; David E.M. Sappington, Price Regulation and Incentives, December 2000, at 14, available at: http://regulationbodyofknowledge.org/wp-content/uploads/2013/03/Sappington_Price_Regulation_and.pdf (Sappington, Price Regulations and Incentives). Price cap plans also may regulate service quality using a reward- or penalty-style "Q-factor." See Sappington, Price Regulations and Incentives at 14-15, 51; Copenhagen Economics, Postal Quality and Price Regulation, March 29, 2017, at 18 n.19 (Copenhagen Economics Report). Other adjustment factors include a "Y-factor" to address recurring exogenous costs, or a "Z-factor" to address an exogenous one-time cost. See RARC-WP-13-007 at 16.

⁶⁵ Order No. 26 at ¶¶ 2064-2068 (deferring the development of adjustments to the CPI-U price cap related to the quality of service); Order No. 43 at 31-32 (same).

PAEA's statutory objectives. Order No. 26 at ¶ 2068. The proposed adjustments generally maintain an inflation-based price cap, while also recognizing the aspects of the initial ratemaking system that have proven to be inadequate to meet the statutory objectives, taking into account the statutory factors.

However, even if the Commission's proposal is construed to be an "alternative system," the Commission has the authority under paragraph (d)(3) to implement such a change. ABA, ANM *et al.*, and NPPC *et al.* assert that the Commission's proposal exceeds the Commission's statutory authority.⁶⁶ Fundamentally, these commenters disagree with the Commission's interpretation of paragraph (d)(3) as providing for a broad scope of review and permitting broad rulemaking action, if necessary to achieve the PAEA's statutory objectives.⁶⁷ Instead, these commenters assert that the authority provided by paragraph (d)(3) is limited to the type of initial regulatory setup and periodic improvements authorized by subsection (a) of section 3622.⁶⁸

The Commission continues to find that the scope of the system subject to review (and subject to potential change or replacement, if necessary to achieve the statutory objectives), includes all aspects of the ratemaking system established under 39 U.S.C. § 3622.⁶⁹ This holistic interpretation properly gives the statutory language its ordinary meaning.⁷⁰ "System" is a general term referring to a set of connected things or parts forming a complex whole.⁷¹ The PAEA expressly "include[s]" the CPI-U price cap in the

⁶⁶ ABA Comments at 4-6; ANM *et al.* Comments at 9-29; NPPC *et al.* Comments at 19-40.

⁶⁷ ABA Comments at 4-6; ANM *et al.* Comments at 11-13; NPPC *et al.* Comments at 21, 23-27.

⁶⁸ ABA Comments at 5-6; ANM *et al.* Comments at 12-13; NPPC *et al.* Comments at 23-27.

⁶⁹ Order No. 4258 at 25; *see also* Order No. 4257 at 10.

⁷⁰ *See Smith v. United States*, 508 U.S. 223, 228 (1993) (in the absence of an express definition, a statutory phrase must be given its ordinary meaning).

⁷¹ *See Merriam-Webster Dictionary*, available at: <http://www.merriam-webster.com/dictionary/system> ("system" defined as "a regularly interacting or interdependent group of items forming a unified whole").

“system for regulating rates and classes for market-dominant products.” 39 U.S.C. § 3622(d)(1)(A). Therefore, the CPI-U price cap is plainly a part of the system that is subject to review under paragraph (d)(3) and, if necessary to achieve the statutory objectives, subject to potential change or replacement.

The structure of subsection (d) of section 3622 confirms the Commission’s interpretation. Subsection (d), titled “Requirements” is subdivided into three paragraphs: (d)(1) “In General;” (d)(2) “Limitations;” and (d)(3) “Review.” Paragraph (d)(2) modifies the preceding text appearing in paragraph (d)(1). This structure reinforces the conclusion that the general provisions of paragraph (d)(1) and the limitations of paragraph (d)(2) are part of the system to be reviewed (and, if necessary to achieve the statutory objectives, changed or replaced) pursuant to paragraph (d)(3).⁷²

The textual differences between subsection (a) “Authority Generally” and paragraph (d)(3) “Review,” clearly demonstrate that the extent of action permissible under paragraph (d)(3) is plainly broader than the extent of the action authorized by subsection (a). Order No. 4258 at 17. The phrase “establish (and may from time to time thereafter by regulation revise)” appearing in subsection (a) plainly refers to two connected powers—the initial setup of the ratemaking system, which *must* be completed within a specific timeframe, and periodic adjustment, which *may* occur at any time thereafter at the Commission’s discretion. On the other hand, the plain language of paragraph (d)(3) demonstrates that its specific authority, if triggered, is broader. The phrase “make such modification or adopt such alternative system for regulating rates and classes for market-dominant products as necessary to achieve the objectives”

⁷² The Commission notes, however, that the provisions appearing in paragraphs (d)(1) and (d)(2) do not represent the entirety of the system established under section 3622 that is subject to review and possible change and/or replacement pursuant to paragraph (d)(3). See Order No. 4258 at 18-19, 25. As discussed in Order No. 4258, the structure of the PAEA does not preclude the inclusion of workshare discounts, which are described in subsection (e) of section 3622, as part of the overall system established under section 3622. *Id.* at 18-19.

appearing in paragraph (d)(3) plainly refers to two options with different meanings—either changes to, or the complete replacement of, any part of the system in order to remedy a failure to achieve the statutory objectives. Unlike subsection (a), the second sentence of paragraph (d)(3) contains specific triggering conditions. Any action authorized under paragraph (d)(3) is contingent on the Commission completing a mandatory review 10 years after the PAEA's enactment and issuing a determination (subject to notice and comment) that the ratemaking system did not achieve the PAEA's statutory objectives (taking into account the statutory factors).

The differing statutory context under which the Commission acts—subsection (a) versus paragraph (d)(3)—determines the extent of the Commission's rulemaking authority. See Order No. 4258 at 17-18. Reading the statute as a whole makes it clear that the statutory objectives and factors play different roles to effectuate the different purposes of subsection (a) and paragraph (d)(3). Subsection (a) does not mention the objectives and factors. Instead, subsections (b) and (c) explain the role of the objectives and factors during the course of any rulemaking undertaken pursuant to subsection (a). When performing the time-sensitive mandatory setup of the ratemaking system, and when making periodic discretionary adjustments to that system under subsection (a), the objectives and factors play a background role in implementing the general requirements and limitations specified in paragraphs (d)(1)-(2). By contrast, paragraph (d)(3) casts the objectives in the primary role (with a supporting role for the factors). The purpose of paragraph (d)(3) is plainly to ensure that the objectives are being met and, if needed, to empower the Commission to remedy any failure to meet the objectives.

ANM *et al.* and NPPC *et al.* maintain that the Commission's authority under paragraph (d)(3) is subject to the provisions appearing in paragraphs (d)(1) and (d)(2),

such as the CPI-U price cap.⁷³ Essentially, these commenters posit that paragraph (d)(3) only affects the rules the Commission has promulgated in existing 39 C.F.R. part 3010, insofar as those rules conform with paragraphs (d)(1) and (d)(2).

However, nothing in paragraph (d)(3) states that the Commission's review of the system, and the range of action that can be taken in response to that review, is to be limited by the provisions appearing in paragraphs (d)(1) and (d)(2). If Congress had intended to restrict the scope of review or action authorized under paragraph (d)(3), it could have done so easily.⁷⁴ Instead, paragraph (d)(3) permits the Commission to "make such modification or adopt such alternative system for regulating rates and classes for market-dominant products as necessary to achieve the objectives." 39 U.S.C. § 3622(d)(3). This broad language militates against concluding that the commenters' narrow interpretation of paragraph (d)(3) must be unambiguously correct.

ABA, ANM *et al.*, and NPPC *et al.* rely on the presumption of consistent usage to assert that repetition of the phrase "system for regulating rates and classes for market-dominant products" results in the Commission's regulatory power as authorized by paragraph (d)(3) being restricted to the type of action authorized by subsection (a).⁷⁵ However, the presumption of consistent usage "is not rigid and readily yields whenever there is such variation in the connection in which the words are used as reasonably to warrant the conclusion that they were employed in different parts of the act with different

⁷³ See ANM *et al.* Comments at 21, 23; NPPC *et al.* Comments at 23-24.

⁷⁴ See Order No. 4258 at 15; see also *Smith*, 508 U.S. at 229 (rejecting a *Chevron* step one challenge contending that the statutory phrase "use of a firearm" referred only to use as a weapon and did not include use of a firearm as an item of barter to receive drugs, holding that "[s]urely petitioner's treatment of his [firearm] can be described as 'use' within the everyday meaning of that term[.]" and "[h]ad Congress intended the narrow construction petitioner urges, it could have so indicated.").

⁷⁵ ABA Comments at 5-6; ANM *et al.* Comments at 11-13; see also NPPC *et al.* Comments at 23.

intent.”⁷⁶ Applying the presumption mechanically would “ignore[] the cardinal rule that ‘[s]tatutory language must be read in context [since] a phrase ‘gathers meaning from the words around it.’”⁷⁷ Notably, the presumption “relents when a word used has several commonly understood meanings among which a speaker can alternate in the course of an ordinary conversation, without being confused or getting confusing.”⁷⁸

These important caveats demonstrate that the interpretation advanced by the commenters, which would apply the presumption of consistent usage in an isolated and mechanical fashion, lacks adequate support. See *Cline*, 540 U.S. at 595-596 n.8 (internal citations omitted). The repetition of a general phrase cannot override the clear differences in the nature and extent of the Commission’s authority granted by the provisions at issue. The differences in both the text and the purposes of the provisions is evidence that it is improper to equate the general authority granted by subsection (a) with the specific authority granted by paragraph (d)(3). See Order No. 4258 at 16-18.

ABA, ANM *et al.*, and NPPC *et al.* reiterate their assertion that the term “shall,” appearing in paragraph (d)(1), means that the inclusion of the CPI-U price cap in the ratemaking system cannot be reviewed, altered, or eliminated under paragraph (d)(3).⁷⁹ This interpretation ignores the fact that paragraph (d)(3) structurally follows paragraphs (d)(1) and (d)(2), which strongly suggests that the provisions of paragraphs (d)(1) and (d)(2) are subject to modification by paragraph (d)(3).

ANM *et al.* incorrectly assert that the provisions of paragraphs (d)(1) and (d)(2) take precedence over the statutory objectives appearing in subsection (b). ANM *et al.*

⁷⁶ *Gen. Dynamics Land Sys., Inc. v. Cline*, 540 U.S. 581, 595 (2004) (quoting *Atlantic Cleaners & Dyers, Inc. v. United States*, 286 U.S. 427, 433 (1932)).

⁷⁷ *Cline*, 540 U.S. at 596 (quoting *Jones v. United States*, 527 U.S. 373, 389 (1999) (internal citation omitted)).

⁷⁸ *Cline*, 540 U.S. at 595-96 (noting that the word “age” can be readily understood to have different meanings depending on the context) (internal footnote omitted).

⁷⁹ ABA Comments at 5; ANM *et al.* Comments at 11; NPPC *et al.* Comments at 20-22.

Comments at 18. Such an interpretation is contrary to the plain command of subsection (b), which requires the statutory objectives to be applied in conjunction with one another, rather than with any other provisions. Moreover, as discussed, the differing statutory context under which the Commission acts—subsection (a) versus paragraph (d)(3)—determines whether the objectives take on a primary versus a background role. The purpose of paragraph (d)(3) is to ensure that the objectives appearing in subsection (b)—not the provisions of paragraphs (d)(1) and (d)(2)—are being met. If needed, paragraph (d)(3) empowers the Commission to remedy any failure to meet the objectives.

NPPC *et al.* characterize the Commission's interpretation as "dismiss[ing]" the title of section (d)—"Requirements." NPPC *et al.* Comments at 22. They construe this title to be consistent with their position that the CPI-U price cap was intended to be permanent. *Id.* at 22-23. The Commission noted in Order No. 4258 that the section title alone is not dispositive as to whether the Commission may modify or replace the CPI-U price cap.⁸⁰ However, the Commission's interpretation that the general provisions of paragraph (d)(1) and the limitations of paragraph (d)(2) are parts of the system that *must* be reviewed and *may* potentially be changed or replaced under paragraph (d)(3) is consistent with subsection (d)'s title. Specifically, the "Requirements" that were put in place for the first decade following the PAEA's enactment are what are subject to review and potential change or replacement.

NPPC *et al.* contend that the lack of any explicit sunset language means that the CPI-U price cap is permanent and must apply to any system—even an "alternative system" adopted pursuant to paragraph (d)(3). NPPC *et al.* Comments at 22, 25-26. However, no sunset provision was needed for the CPI-U price cap (or for any other aspect of the existing system) because paragraph (d)(3) does not *automatically* remove

⁸⁰ Order No. 4258 at 16; see ANM *et al.* Comments at 21-22 (conceding that title *alone* does not mandate retaining the CPI-U price cap).

or alter the CPI-U price cap (or any other aspect of the existing system). For instance, if the Commission's review had determined that the ratemaking system (including the CPI-U price cap) was achieving the statutory objectives, then the CPI-U price cap system could have continued in its existing form.

Additionally, with respect to NPPC *et al.*'s focus on the lack of explicit sunset language, they misapply the canon regarding narrow construal of statutory exceptions. NPPC *et al.* Comments at 26. It is true that generally speaking, where Congress specifically enumerates certain exceptions to a general prohibition, additional exceptions are not to be implied. See *Andrus* 446 U.S. at 616–17. However, the Commission's interpretation does not rest on creating an *implied* exception to the CPI-U price cap. Section 3622 expressly includes the CPI-U price cap as a part of the system subject to review and potential change or replacement.

ANM *et al.* assert that the phrase “adopt such alternative system” does not meaningfully differ from the phrase “make such modification.” ANM *et al.* Comments at 17. However, the Commission's interpretation does not rely on an appreciable difference between these words alone. As the Commission explained in Order No. 4258, the surrounding words and the use of a parenthetical connote a connection between the regulatory powers “establish” and “revise” in subsection (a), while the text of paragraph (d)(3) plainly confers the discretion to choose between two options with different meanings—either “modify” or “adopt an alternative.” Order No. 4258 at 14, 16-17. As a result, the text of the second sentence appearing in paragraph (d)(3) is more naturally interpreted as presenting a contrast. The interpretation advanced by ANM *et al.* would drain the ordinary meaning from the phrase “alternative system,” which connotes a far more fundamental degree of change than “modification.”⁸¹ It

⁸¹ Order No. 4258 at 15; see Postal Service Reply Comments at 13-14; Public Representative Reply Comments at 9. As the Postal Service states, “[t]he CPI-only price cap simply does not leave a wide enough range of unresolved issues for the Commission to make changes fundamental enough to qualify as being between ‘alternative systems.’” Postal Service Reply Comments at 13.

would also ignore the use of “or,” a disjunctive that connects terms with separate meanings. Order No. 4258 at 14. Therefore, a plain reading of the text of the PAEA does not support the contention that “adopt such alternative system” is synonymous with, or merely intended to explicate the meaning of, “make such modification.”

The interpretation that the types of procedural and technical issues considered during prior rulemakings under subsection (a) are the *sole* meaning of an “alternative system” that may be adopted under paragraph (d)(3) is inconsistent with the sweeping terms used to describe the remedial power provided by paragraph (d)(3).⁸² Had Congress intended only to allow the Commission to recalibrate the regulations implementing the CPI-U price cap in order to make them more consistent with the PAEA’s statutory objectives, it would have been simple (and more natural) for Congress to have drafted the second sentence of paragraph (d)(3) accordingly.

Moreover, the interpretation that the specific authority conferred by the second sentence appearing in paragraph (d)(3) is no greater than the authority conferred by subsection (a) would run counter to the fundamental principle that a statute should be interpreted so as not to render any one part of it inoperative.⁸³ This interpretation would emasculate the specific authority conferred by paragraph (d)(3) of any power independent of the Commission’s standing discretionary authority to change the implementing regulations promulgated pursuant to subsection (a). See 39 U.S.C. §§ 503, 3622(a). ANM *et al.* and NPPC *et al.* assert that the difference between

⁸² See *Nat’l Cable & Telecomm. Ass’n v. FCC*, 567 F.3d 659, 664-665 (D.C. Cir. 2009) (rejecting a *Chevron* step one challenge contending that the FCC’s statutory authority was limited to a specific application where the plain language of the statute supported a broad application); *Consumer Electronics Ass’n v. FCC*, 347 F.3d 291, 297-299 (2003) (same).

⁸³ See *Safeco Ins. Co. of Am. v. Burr*, 551 U.S. 47, 59-60 (2007) (rejecting an interpretation that would render a word superfluous and incompatible with the statutory structure); *Montclair v. Ramsdell*, 107 U.S. 147, 152 (1883) (“It is the duty of the court to give effect, if possible, to every clause and word of a statute, avoiding, if it may be, any construction which implies that the legislature was ignorant of the meaning of the language it employed.”).

subsection (a) and paragraph (d)(3) is that subsection (a) allows the Commission to revise regulations on its own initiative, whereas paragraph (d)(3) *requires* that the Commission undertake a review and possibly make revisions after 10 years.⁸⁴ However, this fails to address how the discretionary regulatory authority triggered by the second sentence of paragraph (d)(3) would be distinct from the Commission's standing discretionary rulemaking authority under subsection (a).

NPPC *et al.* assert that "the Commission's ten-year review role is no more 'insignifican[t]' than its Section 3622(a) role," and "[i]f [section 3622(a)] were a mere formality, why would Congress have felt the need to enact Section 3622(a) at all?" NPPC *et al.* Comments at 27. The Commission addressed this issue in Order No. 4258.⁸⁵ To reiterate, subsection (a) empowered the Commission to promulgate the regulations necessary to implement the PAEA ratemaking system in its initial form, subject to the CPI-U price cap, among other requirements and limitations. Order No. 4258 at 17. Historically, the Postal Rate Commission had not possessed such broad regulatory authority. *Id.* at 17 n.30. Paragraph (d)(3), on the other hand, embodied a legislative compromise that required the newly created Postal Regulatory Commission to review that initial ratemaking system after 10 years in order to determine if it was meeting the PAEA's statutory objectives, taking into account the statutory factors. *Id.* at 17. If the ratemaking system was found not to be meeting the statutory objectives, then paragraph (d)(3) empowered the new Commission to modify the ratemaking system or adopt an alternative ratemaking system. *Id.*

ANM *et al.* and NPPC *et al.* assert that the PAEA unambiguously precludes the Commission from making additional rate adjustment authority available to the Postal Service.⁸⁶ However, these commenters cannot prevail under *Chevron* step one

⁸⁴ ANM *et al.* Comments at 19; NPPC *et al.* Comments at 27.

⁸⁵ Compare NPPC *et al.* Comments at 27, with Order No. 4258 at 17.

⁸⁶ NPPC *et al.* Comments at 28; ANM *et al.* Comments at 11, 22, 24.

because they have not shown that the PAEA clearly forecloses the Commission's interpretation. They fail to demonstrate that the "system" may *only* be interpreted to refer to regulations that are subject to the provisions appearing in paragraphs (d)(1) and (d)(2). For the foregoing reasons, the Commission concludes that the plain language of paragraph (d)(3) permits the Commission to review and, if necessary to achieve the PAEA's statutory objectives, modify and/or replace all aspects of the ratemaking system, including the CPI-U price cap.

b. The Reasonableness of the Commission's Interpretation

In the alternative, for the reasons discussed in Order No. 4258 and amplified above, the PAEA is at most ambiguous on the question of whether the adjustments to the CPI-U price cap proposed by the Commission are within the scope of the phrase "make such modification or adopt such alternative system for regulating rates and classes for market-dominant products as necessary to achieve the objectives." 39 U.S.C. § 3622(d)(3). To the extent that paragraph (d)(3) may be ambiguous, the Commission's interpretation is reasonable and thus would be entitled to *Chevron* deference.⁸⁷ Under *Chevron* step two, courts "focus on whether the [agency] has reasonably explained how the permissible interpretation it chose is rationally related to the goals of the statute."⁸⁸ "If the statute is ambiguous enough to permit the agency's

⁸⁷ An agency may argue in the alternative as to whether its reading of a statute is proper under *Chevron* step one or *Chevron* step two. See, e.g., *United Parcel Serv., Inc. v. Postal Reg. Comm'n*, 890 F.3d 1053, 1063 (D.C. Cir. 2018) ("Given our conclusion that the Commission's reading of 'institutional costs' is reasonable and so merits our deference [under *Chevron* step two], we need not consider the Commission's argument that, under *Chevron* [step one], its reading is not only permissible, but also unambiguously correct."); *Decatur County Gen. Hosp. v. Johnson*, 602 F. Supp. 2d 176, 186 n.6 (D.D.C. 2009) (holding that agency's decision to apply cost reduction factors to base year costs was entitled to deference under *Chevron* step two, where the agency also provided an alternative justification under *Chevron* step one).

⁸⁸ *Petit*, 675 F.3d at 785 (citing *Village of Barrington*, 636 F.3d at 665 (internal quotation marks omitted)).

reading,...[courts] defer to that interpretation so long as it is reasonable.”⁸⁹ Therefore, in the alternative, if paragraph (d)(3) is determined to be ambiguous, the foregoing plain language analysis would be equally applicable to explain how the Commission’s reasonable interpretation is consistent with the text, context, structure, and purpose of the PAEA.

Furthermore, to the extent that any ambiguity exists with regard to paragraph (d)(3), it is also permissible for the Commission to use Senator Collins’ floor statement as an interpretative aid and reasonable for the Commission to conclude that paragraph (d)(3) would allow the Commission to make additional rate adjustment authority available to the Postal Service. ABA, ANM *et al.*, and NPPC *et al.* assert that Senator Collins’ statement must be disregarded because it is not an authoritative expression of legislative intent (such as an official committee report).⁹⁰ However, floor statements by key individuals, such as legislative sponsors, especially where no legislators offered contrary views, help illuminate the purpose of a piece of legislation.⁹¹ Floor statements are particularly instructive in clarifying the purpose of language where no other evidence of legislative intent exists.⁹²

Paragraph (d)(3) did not appear in any prior version of the PAEA, nor was it addressed in any hearings or committee reports. Order No. 4258 at 21. Following the

⁸⁹ *Nat’l Cable & Telecomm. Ass’n*, 567 F.3d at 663 (citing *Consumer Electronics Ass’n v. FCC*, 347 F.3d 291, 299 (D.C. Cir. 2003)).

⁹⁰ See ABA Comments at 6; ANM *et al.* Comments at 25-26; NPPC *et al.* Comments at 28-29.

⁹¹ See *Fed. Energy Admin. v. Algonquin SNG, Inc.*, 426 U.S. 548, 564 (1976) (finding that an uncontradicted floor statement by one of the legislation’s sponsors “deserves to be accorded substantial weight in interpreting the statute”).

⁹² See *North Haven Bd. of Educ. v. Bell*, 456 U.S. 512, 526-527 (1982) (finding remarks on the Senate floor by “the sponsor of the language ultimately enacted[] are an authoritative guide to the statute’s construction” where no committee report addressed the provisions at issue); *St. Louis Fuel & Supply Co. v. FERC*, 890 F.2d 446, 449 (D.C. Cir. 1989) (finding that sponsors’ floor statements were “the only evidence of congressional intent,” and concluding that such remarks “necessarily have some force” and “carry ‘substantial weight’” (internal citation omitted)).

passage of two different postal reform bills, key members of the House and the Senate (including Senator Collins) negotiated a compromise.⁹³ The final text of the PAEA was introduced in a new bill and was approved without amendment by both the House and the Senate.⁹⁴ Paragraph (d)(3) first appeared in this final version.⁹⁵ Neither the presidential signing statement nor any other floor statements addressed paragraph (d)(3).⁹⁶ Accordingly, Senator Collins' floor statement is the best source of legislative history to shed light on the purpose of paragraph (d)(3).

Senator Collins' floor statement demonstrates that Congress contemplated the breadth of the Commission's authority to review and, if needed, to change or replace the ratemaking system, if the Commission determined that the existing system was not achieving the statutory objectives. See Order No. 4258 at 22-23. Senator Collins' statement confirms that Congress considered the CPI-U price cap to be a part of the system subject to the Commission's authority under paragraph (d)(3). See *id.* Moreover, the statement eschews any interpretation that paragraph (d)(3) was intended to deny the Commission the authority to alter or replace the CPI-U price cap. In numerous places, Senator Collins explained that the PAEA guaranteed that the CPI-U price cap would exist for a *minimum* of 10 years.⁹⁷ Senator Collins explained that the 10-year review would occur and discussed potential outcomes: either the Commission would decide to retain the CPI-U price cap in its current form; the Commission would

⁹³ 151 Cong. Rec. H6511, H6548-H6549 (daily ed. Jul. 26, 2005) (Roll Call No. 430) (reflecting a vote of 410-20 in the House); 152 Cong. Rec. S898, S927-S942 (daily ed. Feb. 9, 2006) (reflecting approval by unanimous consent in the Senate); 152 Cong. Rec. H9160, H9179 (daily ed. Dec. 8, 2006) (statement of Rep. Tom Davis).

⁹⁴ 152 Cong. Rec. H9160-H9182 (daily ed. Dec. 8, 2006); 152 Cong. Rec. S11821-S11822 (daily ed. Dec. 8, 2006); see also 152 Cong. Rec. D1153, D1162 (daily digest, Dec. 8, 2006).

⁹⁵ H.R. 6407, 109th Cong., at 7 (2006).

⁹⁶ Statement on Signing the Postal Accountability and Enhancement Act, 42 Weekly Comp. Pres. Doc. 2196-2197 (Dec. 20, 2006), 2006 U.S.C.C.A.N. S76 (2006); 152 Cong. Rec. H9160-H9182 (daily ed. Dec. 8, 2006); 152 Cong. Rec. S11674-S11677, S11821-S11822 (daily ed. Dec. 8, 2006).

⁹⁷ 152 Cong. Rec. S11674-S11675 (daily ed. Dec. 8, 2006) (statement of Sen. Collins).

decide to modify the CPI-U price cap; or the Commission would decide to replace the CPI-U price cap system with an alternative system (subject, of course, to the possibility that Congress could through legislation elect to reinstate the CPI-U price cap). *Id.* This statement directly contradicts any interpretation that the drafters of the PAEA intended for the Commission's 10-year review to redress *only* technical or procedural issues with regard to implementing the CPI-U price cap. Therefore, if the statute is deemed to be ambiguous, this legislative history confirms the reasonableness of the Commission's interpretation of its statutory authority to modify or adopt an alternative system.

Characterizing Congress as having a "longstanding role as the body that sets the benchmark for postal rates," NPPC *et al.* assert that the Commission's interpretation of paragraph (d)(3) would constitute an untenable abdication of power to the Commission by Congress. NPPC *et al.* Comments at 30. However, as the Postal Service observes, "[s]ection 3622 fits within a history of Congressional delegations of decision-making authority concerning postal matters, including ratemaking." Postal Service Reply Comments at 16. Further, as Senator Collins expressly contemplated, Congress may re-impose the CPI-U price cap at any time.⁹⁸

Multiple commenters assert that the Commission's interpretation of paragraph (d)(3) conflicts with statements the Commission has made in the past. In terms of the two-step *Chevron* framework, if the issues are resolved at *Chevron* step one, prior orders of the Commission would not be dispositive. See *Chevron*, 467 U.S. at 842-43 ("If the intent of Congress is clear, that is the end of the matter...."). In the alternative that the issues are evaluated to determine whether the Commission should be accorded deference under *Chevron* step two, it is important to recognize that "[a]n initial agency interpretation is not instantly carved in stone." *Chevron*, 467 U.S. at 863-864. Agencies

⁹⁸ 152 Cong. Rec. S11674-S11675 (daily ed. Dec. 8, 2006) (statement of Sen. Collins).

“must consider varying interpretations and the wisdom of [their] polic[ies] on a continuing basis.” *Id.*

ABA, ANM *et al.*, and NPPC *et al.* cite prior statements appearing in various Commission orders which purportedly corroborate their assertion that the qualitative pricing standards (such as the statutory objectives and factors) are subordinate to the quantitative pricing standards (such as the CPI-U price cap) in all possible iterations of the ratemaking system under the PAEA.⁹⁹ This premise, however, relies on the flawed position (rebutted above) that the scope of review and potential regulatory action under paragraph (d)(3) is limited to the scope of regulatory action authorized under subsection (a). As discussed in Order No. 4258 and detailed below, none of the statements at issue interpret the authority conferred on the Commission by paragraph (d)(3). See Order No. 4258 at 18.

ANM *et al.* assert that the Commission is bound in the instant proceeding by Order No. 26, in which the Commission stated that “[s]ection 3622(d) of the PAEA, captioned ‘Requirements,’ addresses some of the mandatory features the Commission must include in the modern regulatory system.”¹⁰⁰ This statement, included in the background discussion of the notice of proposed rulemaking to promulgate the initial ratemaking system after the PAEA was enacted, interpreted the Commission’s duty to establish (and revise) the initial ratemaking system under subsection (a)—prior to the issuance of a determination pursuant to paragraph (d)(3) that the initial ratemaking system had not achieved the PAEA’s statutory objectives. Order No. 26 at ¶ 2005. The rationale for interpreting paragraph (d)(3) more broadly than subsection (a) has been discussed in Order No. 4258 and further expounded upon in this Order. See Order

⁹⁹ ABA Comments at 5-6; ANM *et al.* Comments at 13-15, 18, 27-29; NPPC *et al.* Comments at 26; see also 2014 ANM *et al.* White Paper at 12.

¹⁰⁰ ANM *et al.* Comments at 13 (quoting Order No. 26 at ¶ 2005).

No. 4258 at 16-18. Prior statements in rulemakings conducted under subsection (a) do not limit the specific authority conferred by paragraph (d)(3).

ANM *et al.* assert that the Commission is bound in the instant proceeding by prior statements in Order No. 536, wherein the Commission purportedly recognized that the PAEA's objectives and factors were subordinate to the PAEA's quantitative pricing standards.¹⁰¹ Again, those statements did not interpret the Commission's authority pursuant to paragraph (d)(3). Instead, they described the level of scrutiny to be applied by the Commission during pre-implementation review of rates (*i.e.*, Market Dominant rate adjustment proceedings), as opposed to post-implementation review (such as through annual compliance review proceedings).¹⁰² With respect to pre-implementation review of Market Dominant rates, the Commission explained that its general focus would be on the quantitative pricing standards (such as the CPI-U price cap and the limitations on excessive workshare discounts), whereas its evaluation of the qualitative standards (*i.e.*, the statutory objectives and factors) would be light and preliminary in nature. Order No. 536 at 17, 34. This stood in contrast to the Commission's pricing role as it had existed under the PRA, which involved pre-implementation review of all rates proposed by the Postal Service according to a list of both quantitative and qualitative ratemaking factors in an omnibus 10-month proceeding. *Id.* at 16. Order No. 536 observed that generally under the PAEA, evaluation of the qualitative standards would be deferred to post-implementation review. *Id.* at 17, 34. Accordingly, the Commission noted that "the qualitative standards usually remain in the background when the Postal Service selects and implements market dominant rates."¹⁰³ Regardless, paragraph

¹⁰¹ Order No. 536 at 16-17, 35-36; ANM *et al.* Comments at 13-14 (citing Order No. 536 at 16-17, 35-36 (emphasis added)), Appendix A at 12-14 (quoting Order No. 536 at 16, 34, 36, 37).

¹⁰² Order No. 536 at 16; see 39 U.S.C. §§ 3652; 3653 (ACRs and ACD proceedings).

¹⁰³ *Id.* at 17. The Commission notes that its interpretation of the role of the quantitative pricing standards relative to the qualitative ones within the specific context of a rate adjustment proceeding, as embodied in Order No. 536, was recently rejected by the United States Court of Appeals for the D.C. Circuit. See *Carlson v. Postal Reg. Comm'n*, 938 F.3d 337 (D.C. Cir. 2019).

(d)(3) gives rise to a different statutory context, in which the statutory objectives are cast as the focal point, with a supporting role for the statutory factors. Paragraph (d)(3) expressly authorizes the Commission to modify or replace the ratemaking system as necessary to achieve the statutory objectives. As such, the level of scrutiny to be applied in rate proceedings or during an annual compliance review proceeding is unrelated to the extent of the Commission's authority under paragraph (d)(3).

ANM *et al.* assert that the Commission is bound in the instant proceeding by prior statements to the effect that the price cap takes precedence over Factor 2 (39 U.S.C. § 3622(c)(2)), which requires coverage of attributable costs.¹⁰⁴ However, these statements were made in the context of ACDs concerning the non-compensatory status of the Periodicals mail class in FY 2010 and FY 2011.¹⁰⁵ In both of these years, the Commission directed the Postal Service to improve Periodicals' cost coverage through means other than rate increases that would be in excess of the CPI-U price cap, including through operational efficiency enhancements, cost controls, and improved pricing signals.¹⁰⁶ This directive was consistent with the requirement that the Commission take into account Factor 2, which requires that each class of mail or type of mail service bear the direct and indirect postal costs attributable to it, when determining compliance for purposes of 39 U.S.C. § 3653.¹⁰⁷ These statements were made at an

¹⁰⁴ ANM *et al.* Comments at 14 (citing *U.S. Postal Serv. v. Postal Rate Comm'n*, 676 F.3d 1105, 1108 (D.C. Cir. 2012), on remand, Order No. 1427 at 17-19, Appendix A at 14-15 (quoting FY 2010 ACD at 18-19; Order No. 1427 at 17; Docket No. ACR2011, *Annual Compliance Determination*, March 28, 2012, at 17 (FY 2011 ACD))).

¹⁰⁵ See FY 2010 ACD at 18-19; FY 2011 ACD at 17.

¹⁰⁶ FY 2010 ACD at 17; Order No. 1427 at 17-18; FY 2011 ACD at 17. It is also worth noting that the Commission did not find the Periodicals class out of compliance in FY 2010 or FY 2011; therefore, the Commission did not address the scope of its remedial power under 39 U.S.C. § 3653(c). FY 2010 ACD at 17; FY 2011 ACD at 17.

¹⁰⁷ 39 U.S.C. § 3653 requires the Commission to determine annually "whether any rates or fees in effect during such year...were not in compliance with applicable provisions of this chapter...." 39 U.S.C. § 3653(b)(1). One of the "applicable provisions of this chapter" is 39 U.S.C. § 3622(c)(2), which is the second of the PAEA's statutory factors.

early stage of the PAEA ratemaking system, pursuant to the constraints of the system as it was initially established under subsection (a). The statement was, and remains, consistent with the Commission's interpretation of its authority under 39 U.S.C. § 3622(a).

However, after 10 years of experience with the initial ratemaking system, the Commission has determined that the initial ratemaking system is not achieving the PAEA's statutory objectives, taking into account the statutory factors. Order No. 4258 at 2. The Commission has also made specific findings concerning the impact of non-compensatory mail classes and products on the achievement of the statutory objectives. *Id.* at 74-76. The Commission has determined that improving the cost coverage of the Periodicals class, in part through additional rate adjustment authority, is necessary to achieve the statutory objectives. *Id.* at 77-81. Therefore, the authority to adopt the regulations which the Commission has proposed pursuant to paragraph (d)(3) is unaffected by prior statements made by the Commission during annual compliance reviews conducted before paragraph (d)(3) became applicable.

ABA and ANM *et al.* assert that the Commission is bound in the instant proceeding by prior statements that "the role of the price cap is central to ratemaking, and the integrity of the price cap is indispensable if the incentive to reduce costs is to remain effective."¹⁰⁸ These statements were made in the context of limiting exigent rate increases under 39 U.S.C. § 3622(d)(1)(E) to circumstances that qualified as extraordinary or exceptional.¹⁰⁹ Specifically, these statements were used by the Commission to support its interpretation of the causal nexus required by the phrase "due to" appearing in section 3622(d)(1)(E). Order No. 864 at 32. These statements

¹⁰⁸ See 2017 ABA Comments at 8 n.14 (quoting Order No. 547 at 49-50); ABA Comments at 5 n.4 (same); see also ANM *et al.* Comments at 14-15 (citing Order No. 547 at 10-13, 49-50), (quoting Order No. 864 at 32-33).

¹⁰⁹ Order No. 547 at 49-50; see 39 U.S.C. § 3622(d)(1)(E).

were made at an early stage of the PAEA ratemaking system, pursuant to the constraints of the system as it was initially established under subsection (a). Furthermore, the rules proposed by the Commission in this Order do not make any substantive changes to the PAEA's exigency provision.¹¹⁰ Therefore, these out-of-context statements are misplaced in the instant proceeding.¹¹¹

ABA and ANM *et al.* are incorrect in asserting that the Commission has made an "unexplained departure from the Commission's prior findings" concerning its policy of strictly enforcing the CPI-U price cap in order to protect captive mailers from abuse as a result of the postal monopoly.¹¹² "Agencies are free to change their existing policies as long as they provide a reasoned explanation for the change."¹¹³ The agency must explain "that the new policy is permissible under the statute, that there are good reasons for it, and that the agency believes it to be better."¹¹⁴

As described in Order No. 4258 and in this Order, the proposal to make additional rate adjustment authority available to the Postal Service is permissible under the PAEA and is adequately justified. The Commission has determined that the current ratemaking system is not achieving the PAEA's statutory objectives, taking into account the statutory factors, and the Commission has provided extensive findings in support of

¹¹⁰ Non-substantive changes are proposed to the existing rules governing rate adjustments due to extraordinary and exceptional circumstances, such as the simplification of terminology and reorganization. Order No. 4258 at 108, 126.

¹¹¹ Additionally, as discussed above, the rules that the Commission is proposing do not jettison the concept of a price cap altogether; rather they make adjustments to the CPI-U price cap in recognition of the fact that aspects of the current ratemaking system have failed to achieve the PAEA's statutory objectives.

¹¹² ANM *et al.* Comments at 28; see also ABA Comments at 5.

¹¹³ *Encino Motorcars, LLC v. Navarro*, 136 S. Ct. 2117, 2125 (2016) (citing *Nat'l Cable & Telecomm. Ass'n v. Brand X Internet Servs.*, 545 U.S. 967, 981 (2005)).

¹¹⁴ *FCC v. Fox Television Stations, Inc.*, 556 U.S. 502, 515 (2009) (emphasis omitted); see also *Nat'l Ass'n of Home Builders v. EPA*, 682 F.3d 1032, 1038 (D.C. Cir. 2012).

this conclusion. See *generally* Order No. 4257. The Commission has found that having an annual limitation on the percentage change in rates (*i.e.*, a price cap) is an aspect of the ratemaking system that furthers the achievement of some of the statutory objectives and factors.¹¹⁵ However, the Commission has also determined that limiting the amount of that annual limitation solely to the percentage change in CPI-U frustrates the achievement of several other objectives and factors.¹¹⁶ Accordingly, evaluating the objectives in conjunction with each other, the Commission has found that raising the amount of the annual limitation is necessary to achieve the objectives. Order No. 4258 at 26-81. In selecting the parameters for allowing such rate increases (such as using a phase-in allocation method for the retirement rate authority rather than a one-time rate increase), the Commission has carefully considered the impact on mailers. Order No. 4258 at 41-45. Several of this Order's revisions to the initial proposal incorporate the concerns of mailers.

c. The Constitutionality of the Commission's Interpretation

Finally, ANM *et al.* and NPPC *et al.* argue that the Commission's interpretation of paragraph (d)(3) raises constitutional concerns under the Constitution's Presentment Clause and non-delegation doctrine.¹¹⁷

With regard to the Presentment Clause, the promulgation of rules by an administrative agency pursuant to a statute does not constitute a legislative act. It is, rather, an exercise of an executive function properly entrusted to administrative agencies, and the Presentment Clause does not apply to it.¹¹⁸ Paragraph (d)(3) does

¹¹⁵ See Order No. 4257 at 103; Order No. 4258 at 34.

¹¹⁶ See Order No. 4257 at 178; Order No. 4258 at 33-35, 46-53.

¹¹⁷ NPPC *et al.* Comments at 31-40; ANM *et al.* Comments at 18 n.5; see also 2017 ANM *et al.* Comments at 9-10 n.2; 2014 ANM *et al.* White Paper at 17-21. In response to Order No. 4258, ANM *et al.* do not introduce additional argument in support of this position.

¹¹⁸ See, e.g., *American Trucking Assn's, Inc. v. United States*, 344 U.S. 298, 310-313 (1953).

not authorize the Commission to amend or repeal portions of the PAEA—it merely grants the Commission the power to promulgate new regulations as contemplated by the PAEA.

Nevertheless, even if the Presentment Clause were applicable, the authority cited by ANM *et al.* and NPPC *et al.* is distinguishable from the instant case. In *Clinton*, 524 U.S. 417, the Supreme Court struck down the Line Item Veto Act, which would have permitted the president to selectively cancel certain types of appropriations provisions that had been signed into law by Congress. In so doing, the Court distinguished the Line Item Veto Act from the Court’s earlier decision in *Marshall Field & Co. v. Clark*, 143 U.S. 649. *Field v. Clark* upheld the constitutionality of the Tariff Act of 1890, a tariff and import statute that provided for certain tariff exemptions but directed the president to suspend those exemptions in the future as to any country that he determined was imposing tariffs on U.S. products which were “reciprocally unequal and unreasonable.” *Id.* at 680.

First, the *Clinton* Court noted that the President’s suspension power under the Tariff Act was contingent on conditions that did not exist when the act was passed, whereas the 5-day limit for cancelling an appropriations line item under the Line Item Veto Act meant that the President’s action would necessarily be based on the same conditions contemplated by Congress. *Clinton*, 524 U.S. at 443-444. In passing the PAEA, as with the Tariff Act, Congress anticipated that new conditions might be present 10 years after the law’s passage, which would be materially different from the conditions contemplated by Congress. Congress also recognized that, regardless of any change in conditions, the ratemaking system that it was establishing might, for reasons both unintended and unforeseeable, prove to be less than fully satisfactory. Congress explicitly acknowledged these possibilities by mandating the paragraph (d)(3) review. Congress intended, if there were to be a material change in conditions, or if the ratemaking system were to prove less than fully satisfactory, for the Commission to be

empowered to promulgate revised regulations in order to make the ratemaking system conform to the PAEA's statutory objectives.

Second, the *Clinton* Court noted that the Line Item Veto Act provided little constraint on the President's discretion to cancel a particular appropriations line item, whereas the President's discretion was much narrower under the Tariff Act. *Clinton*, 524 U.S. at 443-444. Under the PAEA, the Commission's discretion in promulgating new regulations is circumscribed by the nine statutory objectives contained in section 3622(b). These objectives constitute substantive requirements that govern any regulations modifying or replacing the ratemaking system. The PAEA also provides procedural requirements that govern any such regulations, such as the requirement that the Commission engage in notice and comment rulemaking.

Finally, the *Clinton* Court considered it important that the President was fulfilling Congress's policy under the Tariff Act when he suspended certain import duty exemptions, whereas he was clearly contravening Congress's policy judgment when he cancelled spending items under the Line Item Veto Act. *Clinton*, 524 U.S. at 444. With regard to the PAEA, it is clear that Congress intended to empower the Commission to modify or replace the initial ratemaking system if, after 10 years, the system was failing to achieve the PAEA's objectives and factors. Therefore, even if the Presentment Clause were applicable to the Commission's proposed rulemaking in this case, the instant situation is distinguishable from *Clinton* and is, in fact, more analogous to *Field v. Clark*.

With regard to the non-delegation doctrine, the Commission agrees with the Postal Service that NPPC *et al.* continue to rely on two cases with limited precedential value. See Postal Service Reply Comments at 8-9. In fact, "[o]nly twice in this country's history...ha[s] [the Supreme Court] found a delegation excessive—in each case because 'Congress had failed to articulate *any* policy or standard' to confine

discretion.”¹¹⁹ These are precisely the two cases NPPC *et al.* cite.¹²⁰ The more extensive and more recent body of case law has upheld broad delegations to agencies “so long as Congress has set out an ‘intelligible principle’ to guide the delegatee’s exercise of authority.”¹²¹ “[A] delegation is permissible if Congress has made clear to the delegatee ‘the general policy’ he must pursue and the ‘boundaries of [his] authority.’”¹²² The Supreme Court has upheld “delegations to various agencies to regulate in the ‘public interest.’”¹²³ It has upheld delegations to “agencies to set ‘fair and equitable’ prices and ‘just and reasonable’ rates.”¹²⁴ It has “affirmed a delegation to an agency to issue whatever air quality standards are ‘requisite to protect the public health.’”¹²⁵

Paragraph (d)(3) easily meets this standard. The Commission is authorized to engage in rulemaking only if it determines that the initial ratemaking system is not meeting the PAEA’s statutory objectives, taking into account its factors, and the Commission may only engage in rulemaking “as necessary to achieve the objectives.” 39 U.S.C. § 3622(d)(3). The nine statutory objectives are more than sufficient to provide an intelligible principle to guide the Commission’s discretion. They make clear

¹¹⁹ *Gundy v. United States*, 139 S.Ct. 2116, 2129 (2019) (emphasis in original) (quoting *Mistretta v. United States*, 488 U.S. 361, 373 n.7 (1989)).

¹²⁰ See NPPC *et al.* Comments at 36 (citing *A.L.A. Schechter Poultry Corp. v. United States*, 295 U.S. 495 (1935); *Panama Refining Co. v. Ryan*, 293 U.S. 388 (1935)).

¹²¹ *Gundy*, 139 S.Ct. at 2129 (quoting *J.W. Hampton, Jr. & Co. v. United States*, 276 U.S. 394, 409 (1928)); see Postal Service Reply Comments at 8-9; see also Order No. 4258 at 24.

¹²² *Gundy*, 139 S.Ct. at 2129 (brackets in original) (quoting *American Power & Light Co. v. SEC*, 329 U.S. 90, 105 (1946)).

¹²³ *Gundy*, 139 S.Ct. at 2129 (quoting *Nat’l Broadcasting Co. v. United States*, 319 U.S. 190, 216 (1943); *New York Central Securities Corp. v. United States*, 287 U.S. 12, 24 (1932)).

¹²⁴ *Gundy*, 139 S.Ct. at 2129 (quoting *Yakus v. United States*, 321 U.S. 414, 422, 427 (1944); *Fed. Power Comm’n v. Hope Natural Gas Co.*, 320 U.S. 591 (1944)).

¹²⁵ *Gundy*, 139 S.Ct. at 2129 (quoting *Whitman v. American Trucking Ass’n, Inc.*, 531 U.S. 457, 472 (2001)).

the general policy that is to be pursued and the boundaries of the Commission's authority. Therefore, NPPC *et al.*'s arguments with regard to the non-delegation doctrine are meritless.

3. Workshare Discounts

With respect to the Commission's workshare discount proposal, GCA and the Postal Service reiterate their position that workshare discounts should not be affected by this proceeding.¹²⁶ However, no additional support for their position was entered into the record. For the reasons discussed in its prior orders, the Commission interprets the scope of the review and regulatory action authorized under paragraph (d)(3) of section 3622 to include workshare discounts.¹²⁷ Accordingly, the Commission may adopt its workshare discount proposal under *Chevron* step one. Paragraph (d)(3) does not clearly foreclose the inclusion of workshare discounts in the "system" subject to review. Nor does this provision clearly foreclose the inclusion of the proposed changes in a modified or alternative system under paragraph (d)(3). In the alternative, if there is any ambiguity as to whether the paragraph (d)(3) would authorize the Commission to adopt this proposal, then the Commission has permissibly construed the PAEA and would be accorded deference under *Chevron* step two.

Even in the alternative that paragraph (d)(3) of section 3622 would not authorize the proposal, the Commission would still be entitled to deference under *Chevron* step two based on other sources of statutory authority. The Commission's workshare discount proposal is within the scope of the Commission's standing rulemaking authority (under 39 U.S.C. §§ 3622(a) and 503) and is consistent with the Commission's specific

¹²⁶ GCA Comments at 1 n.1 (citing 2017 GCA Comments at sections V-VI); Postal Service Reply Comments at 111 n.292 (citing Postal Service Comments at 146-147).

¹²⁷ Order No. 4257 at 12; Order No. 4258 at 18-19.

authority to regulate excessive workshare discounts under subsection (e) of section 3622. Subsection (e) is silent with regard to workshare discounts lower than avoided costs. Order No. 4257 at 34. However, subsection 3622(e) does not clearly foreclose the regulation of workshare discounts lower than avoided costs. Further, the Commission's interpretation "is 'rationally related to the goals of'" the PAEA.¹²⁸ Accordingly, the Commission maintains that it has multiple sources of authority to support addressing workshare discounts in this proceeding.

4. Annual Compliance Reporting Requirements

The Commission also proposes to modify the reporting requirements codified at 39 C.F.R. parts 3050 (Periodic Reporting) and 3055 (Service Performance and Customer Satisfaction Reporting). These modifications both further the achievement of the PAEA's objectives and conform with the changes proposed to 39 C.F.R. part 3010 (Regulation of Rates for Market Dominant Products). Additionally, they are separately authorized under the Commission's specific authority to "prescribe the content and form of the public reports...to be provided by the Postal Service [as part of its *Annual Compliance Report* (ACR)]." 39 U.S.C. § 3652(e)(1). These proposed changes will ensure that the Commission can evaluate the Postal Service's compliance with the new regulations proposed in part 3010 and are necessitated by the public interest. 39 U.S.C. § 3652(e)(2)(C). These proposed reporting requirements relate to Retirement Obligation Rate Authority, Performance-Based Rate Authority, workshare discounts, and cost reductions.

¹²⁸ *Petit*, 675 F.3d at 781 (quoting *Village of Barrington, Ill.*, 636 F.3d at 665).

IV. SUPPLEMENTAL RATE AUTHORITY

A. Introduction

As part of its review of the financial health of the Postal Service, the Commission completed a three-tiered financial stability analysis to examine whether the Market Dominant ratemaking system under the PAEA was maintaining the financial stability of the Postal Service. Order No. 4257 at 159-171. In Order No. 4257, the Commission determined that although short-term stability was achieved under the PAEA, medium- and long-term¹²⁹ stability were not. *Id.* at 165. To be deemed financially stable in the medium-term, the Commission stated that the Postal Service would need to achieve net income, with total revenue exceeding its total costs—both attributable and institutional.¹³⁰ Instead, the Commission found that the Postal Service's total revenue did not exceed the sum of its attributable and institutional costs in any year of the PAEA era, jeopardizing the financial health of the Postal Service. See Order No. 4257 at 168.

In its first NPR, the Commission aimed to put the Postal Service on the path to generating positive net income. See Order No. 4258. The Commission used the \$2.7 billion FY 2017 net loss as the reference point for its calculation of the amount necessary to put the Postal Service on the path towards medium-term financial stability. *Id.* at 40. With the goal of the Postal Service achieving positive net income and using the \$2.7 billion FY 2017 net loss as a reference point, the Commission proposed a 2 percentage point supplemental rate authority per class of mail per calendar year, for 5 years. *Id.* at 42.

¹²⁹ Long-term financial stability is defined as retained earnings. See *id.* at 171.

¹³⁰ *Id.* at 165-166. In Order No. 3673, the Commission defined medium-term stability in terms of "economic profit," defined as total revenue exceeding the sum of variable and fixed cost. Order No. 3673 at 7. The Commission switched to using the term "net income" in Order No. 4257 because that term would be more familiar to Postal Service stakeholders. Order No. 4257 at 165. The Commission also elected to switch to measuring total cost in terms of the sum of attributable and institutional costs, rather than the sum of variable and fixed costs. *Id.*

Commenters argue that it was inappropriate to use the FY 2017 net loss as a reference point and that the additional 2-percentage point rate authority was not tied to specific drivers of the Postal Service's losses. In its revised proposal described below, the Commission proposes to replace the static 2 percent with supplemental rate authority that targets two underlying drivers of the Postal Service's net losses that are largely outside of its direct control: (1) the increase in per-unit cost resulting from the decline in mail density and (2) the statutorily mandated amortization payments for particular retirement costs. The Commission has identified these particular drivers as primary obstacles to the Postal Service's ability to achieve net income.

B. Comments

Comments critiquing the supplemental rate authority proposal generally fall into two key categories: (1) critiques of the FY 2017 net loss as an appropriate reference point and (2) assertions that the 2 percentage point rate authority was not tied to specific drivers of the Postal Service's losses.

In the first category, both the Postal Service and the National Association of Letter Carriers, AFL-CIO (NALC) contend that tying the supplemental authority to a single year's loss distorts the result and that 2 percent per year is not enough additional rate authority to ensure financial stability.¹³¹ The Postal Service and NALC also fault the Commission for not explaining why it chose USPS's net loss in FY 2017 as the basis for calculating the supplemental rate authority. See Postal Service Comments at 57; NALC Comments at 11. NALC further notes that the Commission's proposal depends upon the assumption that Market Dominant mail volume will remain constant. NALC Comments at 10. NPPC *et al.* find that the 2 percent supplemental rate authority

¹³¹ See Postal Service Comments at 56-60; Comment of the National Association of Letter Carriers, AFL-CIO, February 28, 2018, at 9-13 (NALC Comments).

would likely over-recover the intended amount after 5 years and criticize the Commission for relying on the Postal Service's past income to calculate the proposed supplemental rate authority.¹³²

In the second category, the Public Representative maintains that the justification for the 2 percent figure is inadequate, and that the figure has no mathematical relation to "the underlying nature of the problem, particularly in light of the problem of declining demand that causes increases in average costs."¹³³ NPPC *et al.* concur with the Public Representative that the Commission's justification for the 2 percent figure is inadequate, asserting that the Commission did not attempt to determine the amount of revenue required or opine on the proportion of the Postal Service's income that should come from rate increases instead of cost reductions. NPPC *et al.* Reply Comments at 20. GCA similarly asserts that the Commission does not estimate future volume, revenue, or contribution by and of Competitive products. GCA Comments at 7. The Postal Service also states that the 2 percent figure does not take into account specific drivers of loss such as workers' compensation liability adjustments and the rescission of the exigent surcharge. See Postal Service Comments at 55-63. It also notes that the supplemental rate authority fails to take into account any future economic conditions that may affect the Postal Service's financial stability. See *id.* Finally, the Postal Service states that "[a]t the very least, any new price cap must contain some kind of adjustment factor to account for ongoing mail-volume decline and network growth, the primary drivers of the large net losses that the Postal Service suffered under the PAEA." *Id.* at 70.

¹³² See NPPC *et al.* Comments at 59-62; NPPC *et al.* Reply Comments at 24.

¹³³ PR Comments at 18 (quoting Declaration of John Kwoka and Robert Wilson, March 1, 2018, at 12 (Kwoka/Wilson Declaration)).

C. Commission Analysis

The proposed 2 percent supplemental rate authority was a fixed annual percentage referenced to a single fiscal year's loss. The Commission agrees with the commenters that the proposed supplemental rate authority does not adequately respond to ongoing changes that drive the Postal Service's inability to achieve net income.

To address this concern, the Commission proposes to replace the static 2 percent with supplemental rate authority that targets two underlying drivers of the Postal Service's net losses that are largely outside of its direct control: (1) the increase in per-unit cost resulting from the decline in mail density and (2) the statutorily mandated amortization payments for particular retirement costs. The Commission has identified these particular drivers as primary obstacles to the Postal Service's ability to achieve net income.

For density declines, the Commission proposes to modify the price cap to include a formula for additional rate adjustment authority on Market Dominant products approximately equal to the density-driven portion of the increase in average cost per piece. Unlike the Commission's prior supplemental rate authority proposal, the density rate authority would not use a particular fiscal year as a reference point, but would instead be calculated each year based on actual year-over-year changes in density to respond timely to changing conditions.

For the retirement amortization payments, the Commission proposes to modify the price cap to include a formula for additional rate adjustment authority on Market Dominant products equal to the percentage by which total revenue (both Market Dominant and Competitive) would need to increase to provide sufficient revenue to make the statutorily mandated payments.¹³⁴ This additional rate authority would be phased-in over 5 years, and the yearly amounts recalculated annually to take into account changes both in volume and in the amount of the amortization payment. All revenue raised as a result of the use of the retirement rate authority would be required to be remitted towards the amortization payments.

The proposed density rate authority is discussed and analyzed in the next Section, and the proposed retirement rate authority is discussed and analyzed in Section E., *infra*.

D. Density

1. Introduction

The Commission has analyzed the overall commenter critiques of the supplemental rate authority and recognizes that targeting underlying causes of ongoing financial losses is warranted. Both the Public Representative and the Postal Service identify declines in mail density as a driver of net losses and suggest providing the Postal Service with additional rate authority to address continued declines in density. See Section D.2., *infra*.

¹³⁴ The additional rate authority available to Market Dominant products is limited by the proportion of Market Dominant revenue.

The relationship between mail volume and the number of delivery points to which the Postal Service must deliver significantly impacts the Postal Service's per-unit cost. The Postal Service incurs costs at each delivery point.¹³⁵ These costs are spread over the total volume of mailpieces. When delivering a large number of mailpieces, the costs of delivery are spread over a large number of pieces, lowering the per-unit cost. As the number of mailpieces declines, the per-unit cost necessarily increases. The volume per delivery point is referred to as density. The Postal Service does not directly control the volume of mail entered into its network nor the number of delivery points it must service.¹³⁶ Consequently, the Postal Service does not have direct control over density.

2. Comments

Comments addressing density. The Postal Service, the Public Representative, and NPPC *et al.* submitted comments specifically related to the effect of density on the Postal Service's finances.

The Postal Service remarks on the direct effect that network size and declining mail volume have on costs. First, it explains that "providing universal service requires an extensive network" to promote its retail, processing, and delivery operations.¹³⁷ The expansive nature of this network generates large institutional costs which "grow in tandem with the inexorable growth in delivery points." 2017 Postal Service Comments at 99. As a consequence, the Postal Service states that it is "reliant on mail volume to

¹³⁵ All Postal Service costs are classified as either attributable or institutional costs. See, e.g., Docket No. RM2016-2, Order Concerning United Parcel Service, Inc.'s Proposed Changes to Postal Service Costing Methodologies (UPS Proposals One, Two, and Three), September 9, 2016, at 9. ("Attributable costs are costs that are assigned to products on the basis of reliably identified causal relationships.") *Id.* Institutional costs are the residual of attributable costs. *Id.* at 10.

¹³⁶ The universal service obligation requires the Postal Service to deliver to every delivery point. See Report on Universal Postal Service and the Postal Monopoly, December 19, 2008, at 20.

¹³⁷ Comments of the United States Postal Service, March 20, 2017, at 10, 99 (2017 Postal Service Comments).

ensure that its costs are covered” and that it is “highly vulnerable to mail volume declines.” *Id.* at 10.

The Postal Service asserts that its financial stability is linked to economies of density.¹³⁸ As volume declines, it is more difficult for the revenue from remaining mailpieces to cover the costs of delivery. *Id.* Appendix E at 8. Through the analysis of Christensen Associates, the Postal Service explains that while delivery of the mail to individual addresses is a clear illustration of economies of density, economies of density also arise in the collection, sortation, and transportation of the mail. *Id.* As the network expands, the coordination of the flow between different delivery points in the network becomes more complex and costly. *Id.*

The Postal Service views mail volume per delivery point as a critical metric for economies of density. 2017 Postal Service Comments at 99. It shows that mail volume per delivery point peaked in FY 2000, declined thereafter, and experienced a precipitous decline after the PAEA was enacted. *Id.* at 98-99. It further explains that dramatic volume declines ultimately yielded significant increases in the average cost of each mailpiece even before inflation in input costs were included. *Id.* at 99. As for contribution per mailpiece, the Postal Service maintains that it has seen “decline[s] in contribution-weighted volume per delivery point” during the last decade. *Id.* at 11.

¹³⁸ *Id.* at 98-99. Economists often use the term “economies of density” in the context of physical transportation or distribution networks. The Postal Service provides mail service over a network of delivery points. Economies of density exist for the Postal Service because the average cost of the mail decreases as more letters are sent to each address. *Id.* Appendix E at 8 (Christensen Associates, Analysis of the PAEA’s CPI-Based Price Cap System and Options for Future Postal Regulation, March 20, 2017).

The Postal Service states that, due to the price cap regulations and the speed of its revenue decline, the increase in unit cost cannot be offset by any increase in revenue. *Id.* at 57. It, therefore, asserts that the Commission should consider more than unit operating costs or controllable costs when assessing its financial sustainability vis-à-vis the price cap framework. *Id.* at 57.

Similarly, the Public Representative discusses the impact of declining volume on fixed costs and average unit costs through the empirical analyses of John Kwoka and Timothy Brennan.¹³⁹ Kwoka suggests that the “inherently high fixed costs structure” of the postal network coupled with the decline in First-Class Mail volume has resulted in higher average fixed costs. Kwoka Declaration at 25. He states that the increase in average costs are due to “exogenous declines in demand and quantity.” *Id.* The existing price cap formula does not account for these exogenous factors and thus has resulted in a “series of prices that did not capture these exogenous shifts.” *Id.* To capture these shifts, Kwoka recommends a Z-factor¹⁴⁰ term (within the price cap formula) that “adjusts price annually by the amount of the average cost increase” from declining volume. *Id.* at 26.

Brennan explains that the Postal Service’s fiscal condition is uniquely harmed by declining demand due, in part, to having high fixed costs compared to variable operating costs and capped prices. Brennan Declaration at 11. He asserts that revenue decline from lost business “exceed any savings in operating costs” due to the reduced use of services. *Id.* He supports this assertion using data from the Commission’s Analysis of the Postal Service’s Financial Results and 10-K Statement in 2015:

¹³⁹ PR Comments at 35-39, 47-53 (citing Declaration of John Kwoka, March 20, 2017, at 26 (Kwoka Declaration); Declaration of Timothy J. Brennan for the Public Representative, March 20, 2017, at 15-16 (Brennan Declaration)).

¹⁴⁰ Z-factor is the nomenclature used within the price cap framework to describe the increase in average fixed costs due to declining mail volume. Kwoka Declaration at 26.

Of the \$29.6 billion that year in revenues from First-Class Mail, \$13.1 billion is 'attributable cost' and \$16.5 billion is 'contribution to institutional cost.'" If one takes these respectively as shorthand for variable costs and the intended revenue used to include coverage of fixed costs, one could at least roughly estimate that each 1 percent decline in demand would reduce revenues by \$296 million and avoid only \$131 million in variable costs, reducing net revenues (in excess of variable costs) to USPS by \$165 million, the contribution to cover fixed cost, or about 55 percent (165/296) of total revenue. Overall that year, the revenue for market dominant mail and services was \$49.7 billion, with only \$27.1 billion being attributable to specific services and \$22.7 billion labeled as contribution to institutional cost.

Id. at 11-12 (citation omitted). Brennan uses the data to estimate that a 1 percent decline in Market Dominant volume would reduce the Postal Service's revenue (net of variable costs) by \$227 million. *Id.* at 12.

In contrast to the Postal Service and the Public Representative, NPPC *et al.* contend that the Postal Service has had success in controlling its costs despite declines in density, and that there is thus no need for an exogenous adjustment. NPPC *et al.* Reply Comments at 25-26. To support that conclusion, NPPC *et al.* note that city carrier street and rural carrier costs declined by \$650 million (approximately 0.97 percent) in inflation-adjusted dollars from 2007 to 2017.¹⁴¹ NPPC *et al.* focus on total cost, and do not address the impact of declining density on cost per piece.¹⁴²

¹⁴¹ *Id.*; see also NPPC *et al.* Reply Comments, Appendix 1 (showing calculation).

¹⁴² NPPC *et al.* Reply Comments at 25-26. NPPC *et al.*'s own calculations show that, on a per-piece basis, the specific costs identified increased by 37.6 percent in real terms from 2007 to 2017. See NPPC *et al.* Reply Comments, Appendix 1 (showing cost and volume inputs).

Commenter proposals for density rate authority. Both the Public Representative and the Postal Service propose their own formulas to calculate additional rate authority to account for changes in density. Their respective proposals are discussed below.

Public Representative proposal. To address increased average costs due to declining volume, the Public Representative proposes to add a Z-factor to the existing price cap formula.¹⁴³ Kwoka explains that this factor would “adjust price[s] annually by the amount of the average costs increase resulting from declining volumes.” Kwoka Declaration at 26. Kwoka further explains that this, and other Public Representative’s proposed changes, are consistent with the theory and practice of price cap regulation. *Id.*

The Public Representative also asserts that the adjustment mechanism would keep the Postal Service “equally solvent” regardless of the decline in demand.¹⁴⁴ The adjustment mechanism would work as an annual percentage adjustment to the prices, and it is based on three terms: (1) the percentage by which demand has changed; (2) the percentage that average cost changes for a given percentage change in volume; and (3) the price elasticity of demand for the service. Brennan Declaration at 18. The Public Representative’s witness, Dr. Timothy Brennan’s, final proposed price cap Z-factor adjustment term for each class of mail or category of service is:¹⁴⁵

$$\text{Adjustment term} = Z \frac{E_{AC}}{1 - E_{AC}E_D}$$

¹⁴³ Comments of the Public Representative, March 21, 2017, at 41, 44 (2017 PR Comments).

¹⁴⁴ PR Comments at 40-41. Brennan explains that equally solvent means to maintain the amount that the Postal Service contributes to institutional costs. Brennan Declaration at 13.

¹⁴⁵ See Brennan Declaration at 18 (showing formula); *id.* at 15-17 (showing variable definitions); *id.* at 15 (describing formula as applying individually to each class of mail or category of service).

Where,

$$E_{AC} = - \frac{\text{contribution to institutional costs},^{146}}{\text{revenue}},$$

E_D = price elasticity of demand for the Market Dominant service to the adjustment; and

$Z = (-1) * \text{Percent decline in volume for an expressed time period.}$

Postal Service proposal. According to the Postal Service, its proposed revisions to the current price cap framework serve two purposes. The framework directly reflects its expected unit cost trends dictated by factors that impact costs and declining economies of density, and it accounts for exogenous cost changes that are outside of the Postal Service's control. 2017 Postal Service Comments at 211-212.

The Postal Service's proposed "hybrid cap formula" was initially presented in a 2013 report by the United States Postal Service, Office of the Inspector General,¹⁴⁷ in conjunction with Christensen Associates. The Postal Service stipulates that the formula would "adjust the price cap" to allow financial recovery by offsetting the loss in contribution to institutional costs due to declines in volume and mail-mix coupled with the growth in delivery network. Postal Service Comments at 72. The Postal Service's proposal, unlike the Public Representative's proposal, applies equally to all classes that have revenue in excess of attributable costs. The final formula is:

$$\begin{aligned} & \text{Total \% } \Delta \text{ in Rate Authority} \\ &= \text{Baseline Rate Authority} - (\text{Share of Institutional Costs}) \\ &\times (\% \Delta \text{ in Revenue_Weighted Volume} \\ &- \% \Delta \text{ in Number of Delivery Points}) \end{aligned}$$

¹⁴⁶ The numerator—the contribution to institutional costs—is equal to *revenue less attributable costs*. Brennan Declaration at 17.

¹⁴⁷ RARC-WP-13-007 at 14-15.

Where,

Baseline Rate Authority represents CPI-based, unused, supplemental, underwater-class, and capital-funding/performance-based rate authority; and

% Δ in Revenue-Weighted Volume multiplies each Market Dominant product's proportional change in volume (over the immediately preceding year) by that product's share of total Market Dominant revenue in the current year and sums the individual totals.

Id. at 72-73.

The Commission's proposed alternative and how it differs from the commenter proposals are discussed below.

3. Commission Analysis

Overview. The decline in volume combined with the statutorily imposed universal service obligation to deliver to every address have resulted in declining density over the past several years. This, coupled with a price cap limited to CPI, creates a financial dilemma unique to the Postal Service. The existing price cap restricts the Postal Service's prices for Market Dominant products from increasing faster than inflation. This permits the Postal Service to recoup, through revenue increases, increases in per-unit cost driven by inflation, but not necessarily increases in costs that are not driven by inflation. The price cap incentivizes the Postal Service to reduce per-unit cost where it can.¹⁴⁸ However, when per-unit cost increases for reasons outside the Postal Service's direct control the Postal Service must internalize the increase, which worsens its financial position.

The increase in per-unit cost caused by the decline in density is distinguishable from that caused by inflation. Accordingly, the existing price cap system forces the

¹⁴⁸ In Order No. 4257, the Commission found that while during the PAEA era there were cost reductions and efficiency gains, the incentives to achieve cost reductions and efficiency increases were not maximized during the same period of time. Order No. 4257 at 248.

Postal Service to, in the short to medium term, internalize the losses caused by density-driven increases in per-unit cost. The inability of the Postal Service to raise prices to account for these increases in per-unit cost threatens the Postal Service's financial stability by preventing it from achieving net income.¹⁴⁹ The Commission's proposed regulations address this shortcoming of the existing system by authorizing additional rate authority to address increases in per-unit cost resulting from declines in mail density.

The components of density—volume and delivery points—affect attributable and institutional costs differently. The ratio between these costs, known as the institutional cost ratio, serves as a useful tool for estimating how costs can be expected to change in response to changes in density. The Commission's proposed formula relies on the institutional cost ratio to approximate how much the year-over-year decrease in density drives an increase in per-unit cost.

Most attributable costs vary with volume, so as volume declines, total attributable costs will also decrease. By contrast, many institutional costs (including network-related costs) do not vary with volume (at least, in the short- and medium- term), so total institutional costs will not decrease as rapidly as attributable costs as volume declines. Thus, as the institutional proportion of total costs is averaged over fewer pieces as volume declines, total per-unit cost increases. Attributable costs are largely insensitive to the number of delivery points. However, as the number of delivery points increases, institutional costs increase, thereby increasing the per-unit cost.

Formula. The Commission's proposed formula multiplies the institutional cost ratio by the year-over-year change in density to approximate the increase in per-unit

¹⁴⁹ See Order No. 4257 at 165 (analyzing medium-term financial stability in terms of net revenue).

cost driven by the decline in density. Table IV-1 illustrates the calculation of the year-over-year change in density.

Table IV-1
Hypothetical Illustration of Change in Density

	Calculation	Value
Volumes		
Volume in current fiscal year		146,401
Volume in prior fiscal year		149,590
Delivery Points		
Delivery Points in current fiscal year		139
Delivery Points in prior fiscal year		137
Density		
Density in current fiscal year	$146,401 \div 139$	1,053
Density in prior fiscal year	$149,590 \div 137$	1,092
Change in density	$(1,053 \div 1,092) - 1$	-0.0357

This percentage change in density is multiplied by the institutional cost ratio, which is calculated as institutional costs for the fiscal year divided by total costs for the fiscal year. For example, if institutional costs are \$30,724 and total costs are \$74,696, the institutional cost ratio is 41.13 percent. Multiplying 41.13 percent by the change in density of -3.57 percent results in -1.47 percent. This product is multiplied by -1 to obtain the density rate authority. If the result of this calculation is less than zero, the amount of additional density rate authority is zero.

Preventing cross-subsidy of Competitive products. By statute, Market Dominant products are prohibited from cross-subsidizing Competitive products.¹⁵⁰ To prevent cross-subsidization, the Commission calculates the density rate authority two ways: first, using the change in density based on total volume (total density); and second,

¹⁵⁰ See 39 U.S.C. § 3633(a)(1) (prohibiting subsidization of Competitive products by Market Dominant products); 39 U.S.C. § 3622(b)(9) (setting as an objective of the ratemaking system to appropriately allocate institutional costs between Market Dominant and Competitive products).

using change in density based only on Market Dominant volume (Market Dominant density).¹⁵¹ The lesser amount of these two calculations would be the authorized amount of density rate authority.

When Market Dominant volume is declining proportionately faster than Competitive volume, the decline in Market Dominant density will be greater than the decline in Competitive density. The lower decline in Competitive density would dampen the density-driven rise of per-unit cost for all products, including Market Dominant products. In this scenario, the proposed formula limits the amount of density rate authority available for Market Dominant products by using the change in total density rather than the change in Market Dominant density.

By contrast, when Competitive volume is declining proportionately faster than Market Dominant volume, the decline in Competitive density will be greater than the decline in Market Dominant density. The higher decline in Competitive density would *accelerate* the density-driven rise of per-unit cost for all products, including Market Dominant products. In this scenario, the proposed formula limits the amount of density rate authority available for Market Dominant products by using the change in Market Dominant density alone. In this way, revenue from Market Dominant products is not used to subsidize per-unit cost increases that result from the decline in Competitive density.

For example, as illustrated in Table IV-2, suppose during a fiscal year Market Dominant volume were to decline by 2.59 percent, Competitive volume were to grow by 10.8 percent, total volume were to decrease by 2.13 percent, and delivery points were to increase by 1.46 percent. Using the proposed formula the density rate authority

¹⁵¹ The Commission cannot disaggregate delivery points that receive Market Dominant mail from those that receive Competitive mail and those that receive both Market Dominant and Competitive mail. It, therefore, uses Market Dominant volume across all delivery points as an estimate of actual Market Dominant density. A similar calculation can be made for Competitive density.

calculated using total volume would be 1.46 percent and calculated using Market Dominant volume would be 1.64 percent. The Commission would thus calculate the amount of density rate authority using total volume.

By contrast, if Market Dominant volume were to decline by 2 percent, Competitive volume were to decline by 6.99 percent, total volume would decline by 2.19 percent, and delivery points were to increase by 0.72 percent, the density rate authority calculated using total volume would be 1.19 percent, and calculated using Market Dominant volume would be 1.11 percent. The Commission would thus calculate the amount of density rate authority using Market Dominant volume only.

Table IV-2
Hypothetical Illustration of Density Rate Authority Calculation Using
Market Dominant and Total Volume

	Year 1	Year 2	Year 3	Δ Year 1 to Year 2	Δ Year 2 to Year 3
Market Dominant Mail Volume	144,479	140,738	137,923	-2.59%	-2.00%
Competitive Mail Volume	5,111	5,663	5,267	10.80%	-6.99%
Total Mail Volume	149,590	146,401	143,190	-2.13%	-2.19%
Delivery Points	137	139	140	1.46%	0.72%
Institutional Cost Share		41.13%	41.13%		
Density Based on Market Dominant Mail Volume	1,055	1,013	985	-3.99%	-2.70%
Density Based on Total Mail Volume	1,092	1,053	1,023	-3.54%	-2.89%
Density Rate Authority Based on MD Mail Volume				1.64%	1.11%
Density Rate Authority Based on Total Mail Volume				1.46%	1.19%

Ultimately, the Commission's proposed formula ensures that changes in Competitive product volume that *limit* density-driven increases in per-unit cost are permitted to limit density rate authority. Conversely, changes in Competitive product volume that *accelerate* density-driven increases in per-unit cost are not permitted to increase density rate authority. Either way, Market Dominant mailers are protected from

additional price increases that would subsidize Competitive products, in keeping with the statutory prohibition against such subsidies. See note 150, *supra*.

Comparison of Commission's proposal to Public Representative's proposal. The Commission notes two fundamental differences between the Public Representative's proposed adjustment factor and its own. First, the Public Representative's proposal incorporates revenue contribution to institutional costs as a determining factor for additional rate authority.¹⁵² This approach targets a net revenue position rather than focusing solely on uncontrollable cost. By focusing on uncontrollable cost, the Commission's approach preserves the incentives for efficiency created by the price cap. The Public Representative's incorporation of Postal Service revenue, therefore, makes it fundamentally different from the Commission's cost-focused approach.

Second, the Commission notes the nuanced difference of non-price-related volume change versus price-induced volume change within the Public Representative's price elasticity of demand equation. Dr. Timothy Brennan, on behalf of the Public Representative, notes that any increase in the price cap itself will induce a loss in demand.¹⁵³ This price-induced volume change is accompanied by a non-price induced volume change from exogenous factors. The Commission finds that the combination of non-price and price-induced volume change adds a layer of complexity in understanding and implementing the proposed Z-factor. Estimating the non-price induced volume change and the revenue contribution to institutional costs are extraordinarily difficult. In practice, an estimation exercise for these two components of the Z-factor on a class-by-

¹⁵² The Public Representative notes that Dr. Brennan's purpose of the demand adjustment mechanism (Z-factor) is to maintain the Postal Service's net revenue position when demand falls. 2017 PR Comments at 56.

¹⁵³ Supplemental Declaration of Timothy J. Brennan for the Public Representative, March 1, 2018, at 4.

class basis would add an additional layer of complexity to implementation without adding any precision.

Another matter of concern with the approach suggested by the Public Representative is that the formula is to be applied separately to each mail class. This formula recommends a price increase for a mail class only if that mail class's revenue is greater than its attributable costs. Consequently, price increases for Periodicals, which constitute a "non-compensatory" class as defined in Order No. 4258,¹⁵⁴ will never occur through the density factor proposed by the Public Representative until such time that the class is compensatory. The Commission finds this feature of the Public Representative's proposal undesirable, because it does not allow the Postal Service to make any price adjustment for Periodicals without a separate rate increase applied specifically to periodicals.

Comparison of Commission's proposal to Postal Service proposal. The adjustment factor presented by the Postal Service primarily differs from the Commission's density factor in two ways: volume measurement and the concept of density. For volume measurement, the Postal Service uses revenue-weighted volume to capture the change in volume from the preceding year.

The Commission takes a more focused approach by using the decline in density as the basis for increasing price cap authority. The Commission maintains that a focus on revenues does not comport with its goal of compensating the Postal Service for unavoidable increases in unit costs. Compensating for these specific costs maintains the efficiency incentives created by a price cap, whereas those incentives may be weakened when additional rate authority is tied to revenue. Therefore, the

¹⁵⁴ See Order No. 4258 at 73.

Commission's proposal does not weight products by revenue when calculating year-over-year changes in density.

In its analytical derivation, the Postal Service presents its understanding of density decline as the difference between the percentage change in revenue-weighted volume and the percentage change in delivery points. This mathematical expression differs from the Commission's definition of density. The Commission defines density as volume per delivery point and calculates the change in density accordingly.

Conclusion. The proposed density factor is intended to address a shortcoming in the existing price cap system, which fails to account for drivers of loss affecting the Postal Service's financial stability that are outside of its control to remedy. Without additional rate authority to offset density-driven, per-unit cost increases, the Postal Service will be unable to achieve net income, which the Commission identified as necessary to achieve medium-term financial stability. See Order No. 4257 at 165. The Commission intends to continually monitor the additional rate authority provided under the density factor and reserves the authority to adjust as needed if it is no longer necessary to achieve the objectives.

4. Commission Proposal

Overview. The Commission proposes to modify the price cap to permit additional pricing authority based on increases in per-unit cost that are driven by measured declines in year-over-year density, which are outside of the Postal Service's direct control. This proposal addresses many of the criticisms of the Commission's previous medium-term proposal by tying additional pricing authority directly to density losses that cause increases in per-unit cost and are a principal driver of the Postal Service's ongoing losses. By basing each year's rate authority on measured changes in density, this proposal also addresses commenters' concerns about additional rate authority that

would be tied to a single year's data or be otherwise unresponsive to future economic changes, including changes in volume.

The inputs to this formula will be taken from existing data sources.

Formula. The amount of the density rate authority is the greater of zero and:

$$-1 * \frac{IC_T}{TC_T} * \% \Delta D_{[T-1,T]}$$

Where,

T = most recently completed fiscal year;

T-1 = fiscal year prior to year T;

IC_T = institutional cost in fiscal year T;

TC_T = total cost in fiscal year T; and

%ΔD_[T-1,T] = Percentage change in density from fiscal year T-1 to fiscal year T.

Reporting. The reliance on existing data sources limits the need for additional reporting. Volume data will be obtained from the Postal Service's Revenue, Pieces, and Weight (RPW) report, and cost data will be obtained from the Postal Service's ACR as reviewed in the Commission's ACD. Delivery Point data will be obtained from the Postal Service's total factor productivity (TFP) report. Reliance on existing sources provides the additional benefit of transparency for the publicly available inputs used in the formula.

Timing. Using these existing data sources, the Postal Service will file a notice with the Commission by December 31 of each calendar year that calculates the amount of additional rate authority available as a result of declines in density measured in the

previous fiscal year.¹⁵⁵ The Commission will review the Postal Service's calculation and determine how much, if any, density rate authority will be authorized. The Postal Service will have 12 months to implement a rate change that incorporates any authorized density rate authority.

Calculation. The proposed formula for determining the amount of additional rate authority uses the ratio of institutional costs to total costs, multiplied by -1. This ratio is then multiplied by the year-over-year change in density to determine the proportional change in per-unit cost resulting from the observed proportional change in density.

The year-over-year change in density is calculated two ways; once with total density and once with Market Dominant density, and the Commission will use whichever value results in less additional rate authority.

Historical examples. For illustration purposes, Table IV-3 shows the hypothetical amount of density rate authority that would have been authorized in each of the fiscal years from 2013 through 2019, had the density rate authority been in effect in those years. Note that for each of these years, using the change in total density produces less density rate authority than the change in Market Dominant density, but that may or may not be true in future years. The proposed formula cannot be applied as written to years earlier than those shown in the Table because some of the necessary inputs were submitted in reports other than those specified in the proposed draft rules.

¹⁵⁵ Following proposed revisions to the reporting rules in 39 C.F.R. § 3050.21, all of the input data necessary to calculate density rate authority, retirement rate authority, and performance-based rate authority will be submitted to the Commission no later than 90 days after the end of each fiscal year. See 39 U.S.C. § 3652(a) (setting 90-day deadline for the Postal Service's ACR); Attachment A at 66, *infra* (showing proposed revisions to 39 C.F.R. § 3050.21 to include input data and calculations for TFP estimates with the ACR); 39 C.F.R. § 3050.25 (showing 90-day deadline for submission of the Postal Service's RPW report). All of the necessary inputs will thus have been submitted to the Commission no later than December 29 of each year. The proposed rules require the Postal Service to submit initial filings for the density rate authority, retirement rate authority, and performance-based rated authority by December 31 so that the Commission can begin review of the filings as soon as the underlying data are available.

Table IV-3
Hypothetical Density Rate Authority Using Historical Data

FY Density Rate Authority Authorized	Based on Data from FYs	Institutional Cost Ratio	%Δ Density (MD)	%Δ Density (Total)	Density Rate Authority
2013	2011 & 2012	50.06%	-6.06%	-5.38%	2.69%
2014	2012 & 2013	45.84%	-1.89%	-1.51%	0.69%
2015	2013 & 2014	46.60%	-2.94%	-2.68%	1.25%
2016	2014 & 2015	45.69%	-1.92%	-1.57%	0.72%
2017	2015 & 2016	47.15%	-1.11%	-0.76%	0.36%
2018	2016 & 2017	42.62%	-4.53%	-4.04%	1.72%
2019	2017 & 2018	41.13%	-3.41%	-2.95%	1.21%

Source: See Docket No. ACR2011, Library Reference USPS-FY11-42, December 29, 2011, Excel file "FY2011_RPWsummaryreport_public.xlsx," tab "FY 2011 Public," cells L78, L193 (showing Market Dominant and total pieces for FY 2011); Docket No. ACR2012, Library Reference USPS-FY12-1, December 28, 2012, Excel file "FY12PublicCRA.xlsx," tab "Cost3," cells F36:F37 (showing institutional and total cost for FY 2012); Docket No. ACR2012, Library Reference USPS-FY12-42, December 28, 2012, Excel file "FY2012_RPWsummaryreport_public.xlsx," tab "FY 2012 Public," cells L77, L236 (showing Market Dominant and total pieces for FY 2012); Docket No. ACR2013, Library Reference USPS-FY13-1, December 27, 2013, Excel file "FY13PublicCRA.xlsx," tab "Cost3," cells F35:F36 (showing institutional and total cost for FY 2013); Docket No. ACR2013, Library Reference USPS-FY13-42, December 27, 2013, Excel file "FY2013_RPWsummaryreport_public.xlsx," tab "FY 2013 Public," cells L78, L238 (showing Market Dominant and total pieces for FY 2013); Docket No. ACR2014, Library Reference USPS-FY14-1, December 29, 2014, Excel file "public_fy14cra.xlsx," tab "Cost3," cells F34:F35 (showing institutional and total cost for FY 2014); Docket No. ACR2014, Library Reference USPS-FY14-42, December 29, 2014, Excel file "FY2014_RPWsummaryreport_public.xlsx," tab "FY 2014 Public," cells L78, L238 (showing Market Dominant and total pieces for FY 2014); Docket No. ACR2015, Library Reference USPS-FY15-1, December 29, 2015, Excel file "Public-FY15CRARreport.xlsx," tab "Cost3," cells F34:F35 (showing institutional and total cost for FY 2015); Docket No. ACR2015, Library Reference USPS-FY15-42, December 29, 2015, Excel file "FY2015_RPWsummaryreport_public.xlsx," tab "FY 2015 Public," cells L78, L238 (showing Market Dominant and total pieces for FY 2015); Docket No. ACR2016, Library Reference USPS-FY16-1, December 29, 2016, Excel file "Public_FY16CRARreport.xlsx," tab "Cost3," cells F34:F35 (showing institutional and total cost for FY 2016); Docket No. ACR2016, Library Reference USPS-FY16-42, December 29, 2016, Excel file "FY2016_RPWsummaryreport_public.xlsx," tab "FY 2016 Public," cells L78, L240 (showing Market Dominant and total pieces for FY 2016); Docket No. ACR2017, Library Reference USPS-FY17-1, December 29, 2017, Excel file "Public_FY17CRARreport.xlsx," tab "Cost3," cells F34:F35 (showing institutional and total cost for FY 2017); Docket No. ACR2017, Library Reference USPS-FY17-42, December 29, 2017, Excel file "FY2017_RPWsummaryreport_public_eoy.xlsx," tab "FY 2018 Public," cells L78, L240 (showing Market Dominant and total pieces for FY 2017); Docket No. ACR2018, Library Reference USPS-FY18-1, December 28, 2018, Excel file "Public_FY18CRARreport.xlsx," tab "Cost3," cells F34:F35 (showing institutional and total cost for FY 2018); Docket No. ACR2018, Library Reference USPS-FY18-42, December 28, 2018, Excel file "FY2018_RPWsummaryreport_public_eoy.xlsx," tab "FY 2018 Public," cells L74, L236 (showing Market Dominant and total pieces for FY 2018); United States Postal Service, USPS Annual tables, FY 2018 TFP (Total Factor Productivity), July 16, 2019, Excel file "Table Annual 2018 - 2018 CRA Public.xlsx," tab "Out-46," cells K59:69 (showing delivery points for FYs 2013-2018).

E. Retirement Obligations

1. Introduction

The post-retirement benefits offered by the Postal Service include: (1) RHB under the Federal Employees Health Benefits (FEHB) Program; (2) pension benefits under the Civil Service Retirement System (CSRS); and (3) pension benefits under the Federal Employees Retirement System (FERS).

Prior to the PAEA, the Postal Service was required to pay the employer's share of health insurance premiums for all current postal retirees and their survivors who participate in the FEHB Program on a pay-as-you-go basis. The PAEA required the Postal Service to continue to make the "pay-as-you-go" premium payments but also established the RHBF to fund the long-term RHB for postal employees, retirees, and their survivors. The PAEA designated initial funding for the RHBF through certain transfers related to the previous overfunding of the Postal Service's pension liability. It also created a 50-year payment schedule into the RHBF. The payment schedule included considerable annual prefunding payments of \$5.7 billion on average from FY 2007 to FY 2016 and annual payments determined by the Office of Personnel Management (OPM) from FY 2017 to FY 2056. 5 U.S.C. § 8909a(3)(A) and (B). The required annual payments include the present value of estimated total future retirement benefits attributed to services received in the current year (normal cost) and annual amortization payments to liquidate the unfunded accrued actuarial liability¹⁵⁶ by September 30, 2056. 5 U.S.C. §§ 8909a(3)(B) and 8906(g)(2)(A). Beginning in FY 2017, the "pay-as-you-go" premiums are paid out of the RHBF.

¹⁵⁶ Unfunded accrued actuarial liability is the amount by which the present value of the future obligations exceeds the assets in the fund.

The RHBF was expected to generate interest on payments made into the fund and offset the liability for future RHB. While the Postal Service made all required prefunding payments prior to FY 2012, since then the Postal Service has not made any payments into the RHBF.¹⁵⁷

There are two other retiree benefit funds that the Postal Service is required to make payments into beginning in FY 2017—CSRS and FERS pensions.¹⁵⁸ For the CSRS liability, beginning in FY 2017 OPM computed a supplemental liability for the Postal Service's portion of CSRS pension and established an amortization schedule, including a series of annual installments to liquidate the unfunded accrued actuarial liability by September 30, 2043. OPM updates this calculation for each fiscal year through the fiscal year ending September 30, 2038. 5 U.S.C. § 8348(h)(2)(B). The Postal Service has not made these payments.

Regarding FERS liability, until 2013, the Postal Service's portion of the FERS pension had an asset balance exceeding the related accrued actuarial liability, and as such, the funding requirement for the Postal Service's portion of the FERS pension was only the Normal Cost. As of September 30, 2013, and for fiscal years thereafter, OPM has determined a supplemental liability for the Postal Service's portion of the FERS pension and developed a 30-year amortization payment schedule with payments due for each fiscal year. 5 U.S.C. § 8423(b)(2). The Postal Service has not made these payments.

¹⁵⁷ Two of the required annual payments were modified by Congress after the passage of PAEA. The FY 2009 prefunding payment was reduced from \$5.4 billion to \$1.4 billion and the FY 2011 payment of \$5.5 billion was deferred to FY 2012, resulting in a requirement to pay \$11.1 billion in FY 2012. See 5 U.S.C. § 8909a(d)(3)(A).

¹⁵⁸ See Postal Service FY 2018 Form 10-K at 64 for a history of missed retirement payments.

The Postal Service is responsible for funding its RHB and its pension benefits, and with no legislative relief in sight, the Commission is proposing new rate authority to give the Postal Service the ability to begin addressing the shortfalls detailed below.

2. Comments

Many commenters express opinions about the Commission potentially granting the Postal Service additional rate authority to fulfill its statutorily mandated retirement obligations.¹⁵⁹ Of those, several support providing the Postal Service with additional retirement rate authority, some oppose any additional authority for those obligations, and other commenters support some additional authority with suggestions on how the Commission should structure it.

Commenters in favor of additional retirement rate authority. NALC asserts that the Commission's original proposal "largely ignore[d]" the RHB prefunding costs that were imposed on the Postal Service by the PAEA. NALC Comments at 2. It urges the Commission to take the RHB unfunded liability into account when devising a solution in its 10-year review. *Id.* NALC contends that the Commission's solution for medium term financial stability is inadequate because it fails to account for the ongoing RHB liability and varying workers' compensation liabilities over time. *Id.* at 12.

Commenters opposed to additional retirement rate authority. Many commenters contend Congress created the RHB issue and that the Commission should not intervene where a legislative solution is more appropriate. For example, American Mail Alliance (AMA) asserts that the RHB issue is a "Congressional problem that needs a Congressional solution" and despite the Postal Service continuing to default on its

¹⁵⁹ Statutorily mandated retirement obligations include payments for amortization to liquidate pensions (FERS and CSRS) and RHB unfunded obligations. Collectively these retirement liabilities are known as RHB liability.

liabilities, there are no “practical consequences for the Postal Service in terms of its ability to fulfill its mission.”¹⁶⁰ American Forest & Paper Association (AF&PA) echoes this statement by noting that “the financial instability of the Postal Service is not ‘due’ to a deficiency of the rate setting system that the PRC needs to ‘fix’, but...[rather] due to a mandate by Congress that is responsible for approximately 90% of USPS accumulated net losses over the last ten years.”¹⁶¹

The News Media Alliance (NMA) also states that “[t]o the extent that the Commission perceives a problem with the Postal Service’s balance sheet, it should also recognize that significant fault for that deficit lies at the foot of Congress, which imposed the prefunding obligation in order to satisfy a budgetary ‘score’, not address an operational reality.”¹⁶² NMA also asserts that the prefunding requirement is entirely outside of the purview of the Commission’s 10-year review. *Id.*

Similarly, Quad/Graphics maintains that Congress must “step up and eliminate this unneeded prefunding requirement” and characterizes the Commission’s initial supplemental authority proposal as unfair and potentially devastating to mailers.¹⁶³

Commenters such as the Software & Information Industry Association (SIIA) state that the Commission’s proposal would “undermine the opportunities for critical legislative action” by “remov[ing] the incentive for the Postal Service to support legislation that achieves much needed 21st Century reform of the Postal Service,

¹⁶⁰ Comments of the American Mail Alliance, March 1, 2018, at 6 (AMA Comments).

¹⁶¹ Comments of the American Forest & Paper Association, March 1, 2018, at 5 (AF&PA Comments).

¹⁶² Comments of the News Media Alliance, March 1, 2018, at 6 (NMA Comments).

¹⁶³ Quad/Graphics Comments to Order No. 4258, February 28, 2018, at 3 (Quad/Graphics Comments).

including but not limited to its uncontrollable costs” such as the accelerated prefunding for the RHB.¹⁶⁴

The Public Representative rebuts these statements by pointing out that although House Bill H.R. 756¹⁶⁵ would make modifications to the Postal Service’s RHB and pension plans that would reduce the overall costs of these programs; it would not eliminate all exogenous costs associated with retiree and pension liabilities. PR Reply Comments at 14. Additionally, the Public Representative notes that “[e]ven if it is assumed that the solution to the employee benefit payment [program] rests with Congress...unless and until Congress acts real-world consequences have been, and are continuing to be, created by these payment obligations.” PR Comments at 15. He asserts that it is the Commission’s responsibility to address these concerns until Congress acts. *Id.*

ANM *et al.* contend that the Postal Service’s RHB prefunding obligations should not be considered in any analysis of its financial situation because they “are no measure of the Postal Service’s actual ability to honor its obligations to its retirees.” ANM *et al.* Comments at 76.

In contrast, the Public Representative characterizes excluding the Postal Service’s RHB prefunding obligations from any analysis of its financial health as inconsistent with congressional expectations that the Postal Service operate like a private enterprise. PR Reply Comments at 13. He states that “[n]o private commercial enterprise would be expected to cavalierly default on its legal obligations as a means of financing its operations, whether short-term, medium-term, or long-term.” *Id.*

¹⁶⁴ Comments of the Software and Information Industry Association, March 1, 2018, at 12 (SIIA Comments).

¹⁶⁵ See H.R. 746, The Postal Service Reform Act of 2017 (as passed by House Oversight and Government Reform Committee, March 16, 2017).

The Data & Marketing Association and the DMA Nonprofit Federation (DMA) states that the 5-year term proposed for the 2 percent supplemental increase is arbitrary because it is based upon the Commission's timeline for its next planned review and no other relevant factors.¹⁶⁶ It also contends that the amount for the proposed supplemental increase is unreasonable because it amounts to almost doubling the rate of inflation. DMA Comments at 5. If the Commission does choose to adopt supplemental rates that account for the RHB prefunding payments, DMA urges the new regulations to provide for immediate cessation and "reimbursement" of these rates to mailers should Congress enact legislation to eliminate or significantly reduce the unfunded RHB liability or "if economic factors do the same." *Id.* at 6.

Suggested modifications to retirement rate authority. The Postal Service supports the inclusion of "changes in amortization and normal cost payments needed to fund health-care and retirement programs," noting that such amounts "are predictable, recurring non-operational costs that are essentially outside the control of Postal Service management." Postal Service Comments at 70. It asserts that its pension and RHB costs are "not equivalent to costs incurred by the average firm in the broader economy[.]" citing statistics to show that the majority of Fortune 1000 companies and state and federal government employers do not prefund retirement liabilities, and to the extent that any prefunding occurs, it is at a level significantly lower than the 100 percent required of the Postal Service. *Id.* at 75-76. The Postal Service suggests that the price cap should be adjusted by the total change in retirement costs (year over year changes to RHB and FERS normal cost payments, and to amortization payments for RHB, FERS, and CSRS unfunded liabilities) divided by total Market Dominant revenue. *Id.* at 77.

¹⁶⁶ Comments of the Data & Marketing Association and the DMA Nonprofit Federation, March 1, 2018, at 5 (DMA Comments).

Mailers Hub LLC (MH) and the National Association of Advertising Distributors, Inc. (NAAD) state that achievement of financial stability of the Postal Service should be viewed in light of the original intent of the PAEA – the ability to “finance regular operations of the Postal Service and enable it to pay other mandated expenses on the timeline that was concurrently envisioned.”¹⁶⁷ They assert that any supplemental authority allocated should be “modest, relatively permanent, and designed specifically to amortize USPS debt over a period like that proposed in the original forms of PAEA – forty years.” MH/NAAD Comments at 7.

The Public Representative recommends that “mandatory prefunding of retirees’ future health benefits,” as well as the CSRS and FERS unfunded liabilities should be integrated into the price cap as an exogenous cost. PR Comments at 47. Citing the declarations of John Kwoka and Robert Wilson, the Public Representative notes that the Postal Service is required to participate in these programs and the amounts of liability are actuarially determined, giving the Postal Service no control or influence over the benefits. *Id.* The Public Representative suggests that an adjustment to the price cap to include these exogenous costs be phased in over the period between the date of implementation and the conclusion of the next regularly scheduled review of the Market Dominant rate system. *Id.* According to the Public Representative, this next scheduled review should take place in 3 years rather than 5 as proposed by the Commission. *Id.* at 48.

GCA responds to the Public Representative’s suggestion by noting that retiree obligations are the burden of the entire Postal Service, not just the Market Dominant portion.¹⁶⁸ GCA argues that such costs should not be recovered entirely through Market

¹⁶⁷ Comments of Mailers Hub LLC and the National Association of Advertising Distributors, Inc., at 5, March 1, 2018 (MH/NAAD Comments).

¹⁶⁸ Reply Comments of the Greeting Card Association, at 4-5, March 30, 2018 (GCA Reply Comments).

Dominant revenues as the Public Representative proposes. GCA Reply Comments at 5.

Netflix, Inc. (Netflix) points out that the amounts of the Postal Service's prefunding obligations are continually in flux and substantial uncertainty exists regarding congressional action.¹⁶⁹ It suggests that the Commission set up a process to respond to any hardship to ratepayers from large fluctuations. Netflix Comments at 9. Netflix also points out that the Commission's proposal assumes that the Postal Service will pay its continuing obligations despite its history of default. *Id.* It suggests a mid-course review to correct course in case of nonpayment by the Postal Service. *Id.*

Valpak Direct Marketing Systems, Inc. and the Valpak Franchise Association, Inc. (Valpak) states that the supplemental authority proposed by the Commission "must correlate to the purposes for which the funds will be spent."¹⁷⁰ It questions whether the Commission will require that revenue from the proposed supplemental authority be used to cover the unpaid prefunding expenses going forward. Valpak Comments at 12.

3. Commission Analysis

Background and justification. As detailed in Table IV-4, the PAEA established statutory payments to be made by the Postal Service to the Postal Service RHB, the CSRS, and the FERS. See 5 U.S.C. Chapter 89. Beginning in FY 2017, the PAEA required the Postal Service to liquidate the unfunded portion of the RHB and the CSRS liabilities (see 5 U.S.C. § 8348(h) for CSRS and 5 U.S.C. § 8909a for RHB) through an amortization payment schedule. Additionally, the Postal Service is required to continue

¹⁶⁹ Initial Comments of Netflix in Response to Order No. 4258, March 1, 2018, at 7 (Netflix Comments).

¹⁷⁰ Valpak Direct Marketing Systems, Inc. and the Valpak Franchise Association, Inc. Initial Comments on the Notice of Proposed Rulemaking for the System for Regulating Rates and Classes for Market Dominant Products, at 12, March 1, 2018 (Valpak Comments).

to liquidate any unfunded liability in its portion of the FERS pension through an amortization payment schedule. See 5 U.S.C. § 8423(b)(2).

Table IV-4
Retirement Funds Amortization Schedule Beginning 2017

	Funds	Amortization Schedule
Civil Service Retirement System	Civil Service Retirement and Disability Fund	Unfunded liability to liquidate in 27 years (2043)
Federal Employees Retirement System		Supplemental unfunded liability at end of fiscal year to be amortized in 30 years
Retiree Health Benefits	Postal Service Retiree Health Benefits Fund	Unfunded liability to liquidate in 40 years (2056)

Source: 5 U.S.C. § 8348(h)(2)(B); 5 U.S.C. § 8423(b)(2); 5 U.S.C. § 8909a(d)(B).

Several commenters and outside experts noted that the Postal Service's retirement liabilities are a significant impediment to its financial stability. The GAO has also attributed the Postal Service's financial instability to its statutorily mandated prefunding obligations in several of its reports and testimonies.¹⁷¹ In Order No. 4257, the Commission determined "[m]ajor factors influencing the net losses from FY 2012 to FY 2016 were...the RHBF payments." Order No. 4257 at 41 (footnote omitted).

¹⁷¹ See United States Government Accountability Office, GAO 13-112, *U.S. Postal Service: Status, Financial Outlook, and Alternative Approaches to Fund Retiree Health Benefits*, December 2012, at 2 ("We have previously reported that USPS cannot be financially viable until Congress and USPS address the cash flow problems that limit its immediate prefunding capability while also addressing how to pay for the long-term cost of USPS's unfunded retiree health benefit liability"); United States Government Accountability Office, GAO-17-404T, *U.S. Postal Service: Key Considerations for Restoring Fiscal Sustainability (Statement of Lori Rectanus, Director, Physical Infrastructure Issues)*, February 7, 2017, at 6 ("As previously discussed, USPS's unfunded liabilities and debt have become a large financial burden, increasing from 99 percent of USPS revenues at the end of fiscal year 2007 to 169 percent of revenues at the end of fiscal year 2016. These unfunded liabilities and debt—totaling about \$121 billion at the end of fiscal year 2016—consist mostly of retiree health and pension benefit obligations for which USPS has not set aside sufficient funds to cover." (footnote omitted)).

The Postal Service's annual retirement expenses are generally comprised of two components. See 5 U.S.C. § 8909a(d)(3)(b). The first component is the Normal Cost of the annual retirement expense, which is the present value of estimated total benefits attributed to service received in the current year. See 5 U.S.C. § 8909a(d)(3)(b)(i). The Postal Service considers these Normal Costs, or current year retirement costs, as part of an employee's labor costs. As such, they are treated as variable and distributed to the products in the same proportions as total labor costs. The second component is an amortization segment, representing prior year service costs.¹⁷² The current fiscal year's volume does not affect the prior year service costs. This component is considered part of institutional costs.

The Postal Service accrues paid and unpaid retirement amounts as expenses on its income statement. Any unpaid portion of current year or prior year retirement expenses are also classified as liabilities on its balance sheet. OPM considers these liabilities as immediately payable, and as such, the Postal Service categorizes these liabilities as current liabilities payable within a year.¹⁷³ As the Postal Service continues to default on payments for its retirement funds, it continues to accrue the related liabilities.

Although these congressionally mandated payments are outside of the Postal Service's direct control, they continue to be one of the primary drivers of net loss. The PAEA included prefunding requirements for the Postal Service's RHB obligations that were created based on the Postal Service's financial condition at the time. See S. Rep. 108-318 at 2-3. In the initial years after the PAEA was enacted, the Postal Service's financial situation began to unexpectedly decline in ways not anticipated by the PAEA.

¹⁷² See 5 U.S.C. § 8909a(d)(3)(b)(ii). Amortization payment for CSRS is split into current year costs and prior year costs. The current year costs are based on salary expenses that the Postal Service would have incurred for current employees covered by CSRS had the payment to CSRS been required. The PAEA suspended contributions by the Postal Service between FY 2007 and FY 2016.

¹⁷³ United States Postal Service Form 10-K, November 14, 2018, at 45.

As a result, the Postal Service has not made the majority of those payments. The PAEA did, however, authorize the Commission to make necessary modifications to or adopt an alternative system, following a review and after making certain findings related to the system's functioning during the PAEA era. The Commission's proposed rules provide the Postal Service a method to begin to meet those obligations. Given the mounting financial challenges facing the Postal Service, the Commission's proposal provides the Postal Service with both the means and incentive to liquidate its unfunded retirement liabilities and improve its financial health. One of the central determinations of Order No. 4257 was that the ratemaking system has not maintained the financial health of the Postal Service as intended by the PAEA. Order No. 4257 at 247. As such, the Commission's proposed regulations aim to provide the Postal Service with the tools to better fulfill the intent of the PAEA by addressing one of the primary contributors to its financial instability—its amortization payments of RHB, CSRS, and FERS unfunded liabilities.

Calculation and implementation. The proposed regulations would provide the Postal Service with additional authority to generate revenue for the amortization payments of RHB, CSRS, and FERS unfunded liabilities. The amount of additional rate authority would be determined annually, and would be available to the Postal Service to incorporate into a rate change that is implemented within 12 months after the date of the determination. The full additional rate authority would be phased in over 5 years, contingent upon the Postal Service making partial amortization payments towards its unfunded retirement liabilities. The required minimum remittance for these payments is equal to the amount of revenue raised from the additional rate authority during the previous fiscal year.

The proposed formula for calculating the annual amount of retirement rate authority for each year of the phase-in period is detailed below. The formula first calculates the percentage amount by which revenue on all products (both Market

Dominant and Competitive) would need to increase to make the full payment (as calculated by OPM). For example, if the required payment is \$3 billion and total revenue is \$60 billion, the amount revenue would need to increase is 5 percent. Phased in over 5 years, the annual increase needed would be approximately 1 percent.¹⁷⁴

However, because the full amount is being phased in over 5 years, in years after the first it is necessary to account for previously authorized retirement authority that is now incorporated into the rate base. The proposed formula accomplishes this by subtracting the compounded amount of previously authorized retirement rate authority. Therefore, if the required payment is \$3 billion in year two and assuming total revenue remains \$60 billion, the amount of revenue needed expressed as a percent of total revenue is again 5 percent. However, because the prior year's increase of approximately 1 percent has already been implemented, the remaining amount is approximately 4 percent. The remaining amount by which revenue would need to increase is then amortized over the remaining 4 years of the phase-in period, so the next annual increase would again be approximately 1 percent.

By recalculating the retirement rate authority each year as a percentage of the previous fiscal year's total revenue, the proposed formula accounts for volume changes during the phase-in period. If volume declines, the full amortization payment will represent a greater proportion of total revenue, and the proposed formula will provide additional retirement rate authority.¹⁷⁵ Conversely, if volume increases, the full amortization payment represents a smaller proportion of total revenue, and the proposed formula will provide less additional retirement rate authority.

¹⁷⁴ The calculations include the effects of compounding, so in this scenario the annual amount would be slightly less than 1 percent.

¹⁷⁵ Changes in the mix of volumes within products and between products will also be reflected in the calculations and may mitigate or amplify the effects of changes in total volume.

Additionally, because the retirement rate authority is calculated as a percentage of *total* revenue, raising prices by that percentage only on Market Dominant products will not generate enough additional revenue to make the full amortization payment. To generate that much additional revenue the Postal Service would also need to implement an equivalent price increase on Competitive products. The proposed formula thus, ensures that the burden of generating sufficient revenue to pay the full amortization payment does not disproportionately fall on Market Dominant mailers. If the Postal Service does not implement an equivalent competitive rate increase, the formula does not permit greater price increases on Market Dominant products. Regardless of whether the Postal Service implements such a competitive rate increase, the full amount of additional revenue actually collected on Market Dominant products as a result of this retirement rate authority must be submitted towards the Postal Service's amortization payment.

In response to commenter concerns about the Postal Service receiving retirement rate authority without making payments to its amortized liabilities, the availability of the retirement rate authority is contingent upon the Postal Service applying the additional revenue raised by this rate authority to the amortization payments of retirement liabilities, in the form of partial payments. If the Postal Service fails to make payments equal to or greater than the revenue received from this additional authority towards its retirement liabilities after it receives the amount in the first year, it will lose eligibility to receive future retirement rate authority. In each ACD to take place after the first year of implementation, the Commission will review the status of partial payments and may order cessation of retirement rate authority if these payments are not made. At the Commission's discretion, additional equitable remedies, including potential adjustments to rates and/or rate authority, may be implemented if the Postal Service avails itself of the retirement authority without making partial payments.

The Commission's proposed solution provides additional Market Dominant rate authority for the Postal Service to cover a reasonable portion of its non-controllable institutional costs. Commenters have raised concerns about the potential financial impact of the supplemental authority on mailers. By contrast to these concerns, retirement prefunding payments have remained relatively stable and followed a predetermined schedule, and as such, protect Market Dominant mailers by ensuring that rates can be consistently forecast and do not include sudden or extreme fluctuations. See Order No. 4257 at 52. The proposed rules balance the need to provide the Postal Service with a path to financial stability while reasonably balancing the interests of the mailing community, thereby furthering the goal of a ratemaking system that achieves the objectives of section 3622(b) applying each in conjunction with the other objectives.

Many mailers have raised the prospect of comprehensive postal reform legislation by Congress as an argument against providing the Postal Service with retirement rate authority. Accordingly, should Congress enact legislation that impacts the retirement liability of the Postal Service or fundamentally alters the structure of the Postal Service's retiree obligations, the Commission will reevaluate the additional retirement rate authority and consider equitable remedies that may be appropriate to ensure that mailers are protected. The timeframe for reevaluation and the potential remedies will be based on the specific details of any enacted legislation.

Finally, the Commission will review the effect of the additional retirement rate authority 5 years after implementation and will comprehensively analyze its impact. This time period balances the Postal Service's need for additional revenue to make its statutorily mandated payments with minimizing the impact on mailers by spreading the rate increases over time.

4. Commission Proposal

Overview. The Commission proposes to provide additional price cap authority to the Postal Service for the statutorily mandated amortization payments for unfunded retirement liabilities, including RHB,¹⁷⁶ FERS, and CSRS, as computed by OPM for each fiscal year. The Commission's proposed regulations would provide additional price cap authority each year for 5 years. The proposed formula is designed to add sufficient additional rate authority so that at the end of that 5-year period, the Postal Service should generate sufficient additional revenue to pay for the amortization segment of the Postal Service's liability, if accompanied by an equivalent rate increase on Competitive products. The proposed formula adjusts each year based on the previous year's volume and the current amortization payment to ensure that the 5-year target is reached even if conditions change.

The phase-in allocation method is designed to create a predictable and stable schedule for rate increases while minimizing the impact on mailers. The 5-year period provides a balance between the competing priorities of allowing enough time for the effects of the rate increases to be fully known and a short enough period of time to protect mailers from unintended consequences stemming from the rate increases. The Postal Service would be required to make partial payments to its outstanding liability after the first year of obtaining additional revenue under these proposed rules. If the Postal Service fails to make the required partial payment in any given year, it would automatically forfeit the balance of the additional authority. In each year after the phase-in period,¹⁷⁷ the Postal Service will continue to be required to remit towards its

¹⁷⁶ This includes only amortization payments to liquidate the unfunded accrued actuarial liability in accordance with 5 U.S.C. § 8909a(3)(B).

¹⁷⁷ Once the phase-in period is complete, while no new rate authority is added, the rate base would continue to generate revenue that the Postal Service must use to make its amortization payments.

amortization payments all revenue collected as a result of the use of retirement rate authority.

Reporting. The reliance on existing data sources limits the need for additional reporting. The amounts of the amortization payments will be taken from notifications to the Postal Service by OPM of annual determinations of the funding amounts specific to payments at the end of each fiscal year for RHB, CSRS, and FERS. The values for Market Dominant revenue, total revenue, and Market Dominant volumes will be taken from the RPW report.

Timing. Using these existing data sources, the Postal Service will file a notice with the Commission by December 31 of each calendar year that calculates the amount of additional rate authority available under this provision. The Commission will review the Postal Service's calculation and determine how much, if any, retirement rate authority will be authorized. The Postal Service will have 12 months to implement a rate change that incorporates any authorized retirement rate authority.

Formulas and calculation. Formula IV-1 shows how the Commission would calculate the retirement rate authority available during each year of the phase-in period. The first step is to divide the required amortization payment (as calculated by OPM) for the most recent fiscal year by the total revenue from that fiscal year. This proportion, expressed in percentage terms, is the amount by which total revenue would need to increase to make the full payment. From that proportion is subtracted the compounded amount of previously granted retirement rate authority (calculated in Formula IV-2). The resulting difference would then be amortized over the remainder of the phase-in period to determine the amount of retirement rate authority authorized that year.

(Formula IV-1) Retirement rate authority available in fiscal year T+1 =

$$\left(1 + \frac{AP_T}{TR_T} - PARA_T\right)^{\frac{1}{5-N}} - 1$$

Where,

T = most recently completed fiscal year;

AP_T = total amortization payment for fiscal year T;

TR_T = total revenue in fiscal year T;

PARA_T = previously authorized retirement obligation rate authority, compounded through fiscal year T, expressed as a proportion of the Market Dominant rate base and calculated using the formula below; and

N = number of previously issued determinations in which retirement obligation rate authority was made available under this subpart.

Formula IV-2 shows how the Commission would calculate the compounded amount of previously granted retirement rate authority. The sums of 1 plus each previous year's retirement rate authority are multiplied together to determine how much higher rates are than they would have been without any retirement rate authority. The inverse of that product is then subtracted from 1 to express the result as a proportion of the Market Dominant rate base.

(Formula IV-2) Previously authorized retirement obligation rate authority through fiscal year T =

$$1 - \left(\prod_{t=T-N}^T (1 + r_t) \right)^{-1}$$

Where,

T = most recently completed fiscal year;

r_t = retirement obligation rate authority authorized in fiscal year t; and

N = number of previously issued determinations in which retirement obligation rate authority was made available under this subpart.

Formula IV-3 shows how the Commission would calculate the amount of revenue generated in a fiscal year by use of retirement rate authority, and thus the minimum amount that the Postal Service must remit towards its amortization payments to remain eligible for future retirement rate authority. As in Formula IV-2, the sums of 1 plus each previous year's retirement rate authority are multiplied together, except that each previous year's rate authority is prorated (calculated in Formula IV-4) if it came into effect partway during the fiscal year. The inverse of that product is then subtracted from 1 to express the result as the proportion of Market Dominant revenue resulting from use of retirement rate authority. Multiplying that proportion by Market Dominant revenue converts the result into a dollar amount.

(Formula IV-3) Amount of revenue collected during fiscal year T as a result of the use of retirement rate authority =

$$MDR_T \left(1 - \left(\prod_{t=T-N}^T 1 + (p_t)(r_t) \right)^{-1} \right)$$

Where,

T = most recently completed fiscal year;
MDR_T = Market Dominant revenue in fiscal year T;
N = number of previously issued determinations in which retirement obligation rate authority was made available under this subpart;
r_t = retirement obligation rate authority authorized in fiscal year t; and
p_t = prorated fraction of r_t that was in effect during fiscal year T, calculated using the formula below.

Formula IV-4 shows how the Commission would prorate each year's retirement rate authority when calculating its contribution to the total amount of revenue. If a particular year's authority was implemented prior to the start of the fiscal year, all of it is included in the calculation. Conversely, if a particular year's authority was not implemented prior to the end of the fiscal year, none of it is included in the calculation.

If a particular year's authority was first implemented during the fiscal year, a volume-weighted average is taken to calculate how much of that rate authority was in effect during the fiscal year. To do so, the proportion of volume in the quarter of implementation occurring after the date of implementation is added to the total volume for subsequent quarters, and the sum divided by the total Market Dominant volume for the fiscal year.

(Formula IV-4) Prorated fraction of rate authority in effect during fiscal year T =

$$\begin{cases} 0, & \text{if } r_t \text{ was not in effect during fiscal year T} \\ 1, & \text{if } r_t \text{ was in effect for all of fiscal year T} \\ \frac{\left(\frac{E_Q}{D_Q}\right)(QMDV_Q) + \sum_{i=Q+1}^4 QMDV_i}{MDV_T}, & \text{if } r_t \text{ came into effect during fiscal year T} \end{cases}$$

Where,

T = most recently completed fiscal year;

r_t = retirement obligation rate authority authorized under this subpart in fiscal year t;

Q = the number of the quarter during the fiscal year of the effective date of the price increase including retirement obligation rate authority made available under this subpart;

E_Q = number of days in quarter Q subsequent to and including the effective date of the price increase;

D_Q = total number of days in quarter Q;

$QMDV_Q$ = Market Dominant volume in quarter Q; and

MDV_T = Market Dominant volume in fiscal year T.

Hypothetical example. The Commission's proposed formula does not attempt to predict future volume to determine the amount of retirement rate authority available in each year of the phase-in period. Instead, it adjusts annually to changes in both volume and the amount of the amortization payments. The example below is thus a hypothetical scenario for illustrative purposes, and not a forecast. The example assumes that the proposed rules take effect prior to December 2020.

**Table IV-5
Hypothetical Input Data**

FY	Statutorily Mandated Amortization Payment (Millions)	Total Revenue (Millions)	Market Dominant Revenue (Millions)	Quarterly MD Volume			
				Q1	Q2	Q3	Q4
2020	\$3,100	\$70,800	\$46,000	36,095	31,800	31,000	32,000
2021	\$3,000	\$71,400	\$46,389	31,095	31,800	30,000	30,000
2022	\$3,200	\$72,000	\$46,778	29,800	29,000	29,700	29,000
2023	\$3,500	\$73,000	\$47,427	28,800	29,000	28,700	28,000
2024	\$3,400	\$73,900	\$48,011	28,100	28,000	28,800	28,300
2025	\$3,200	\$74,000	\$48,075	28,300	27,900	28,600	28,300

**Table IV-6
Hypothetical Retirement Rate Authority Formula Outputs,
Using Data from Table IV-5**

FY	Compounded Retirement Rate Authority Through Previous FY	Additional Retirement Rate Authority	Date Retirement Rate Authority Authorized	Date of Rate Increase
2021	0.000%	0.861%	January 31, 2021	September 2, 2021
2022	0.853%	0.827%	January 31, 2022	September 15, 2022
2023	1.666%	0.918%	January 31, 2023	September 5, 2023
2024	2.560%	1.111%	January 31, 2024	September 3, 2024
2025	3.631%	0.970%	January 31, 2025	September 6, 2025

Table IV-7
Hypothetical Required Minimum Remittances,
Using Data from Tables IV-5 and IV-6

FY	% of MD Revenue in Previous FY Resulting from Retirement Rate Authority	Required Minimum Remittance (Millions)	To Be Remitted By
2022	0.066%	\$31	September 30, 2022
2023	0.889%	\$416	September 30, 2023
2024	1.729%	\$820	September 30, 2024
2025	2.643%	\$1,269	September 30, 2025
2026	3.695%	\$1,776	September 30, 2026

Table IV-5 shows the full range of input data required by the proposed formula. These data will be obtained from existing data sources. Table IV-6 shows for each year of the phase-in period, the compounded amount of prior retirement rate authority, the amount of rate authority newly authorized, and the dates that authority was authorized (not a formula input or output, but included for illustration) and implemented in a rate increase. Table IV-7 shows the percentage of Market Dominant revenue resulting from the retirement rate authority, the required minimum remittance for each fiscal year, and the date by which it is required to be remitted towards the amortization payment.¹⁷⁸ Note that the required minimum remittance for each fiscal year is equal to the amount of additional revenue collected during the *previous* fiscal year as a result of the prorated, compounded rate increase resulting from the use of retirement rate authority.

The example shows how the proposed formulas use each year's volume and required payment throughout the phase-in period to get closer to the target of generating sufficient additional revenue to (if accompanied by an equal rate increase on

¹⁷⁸ The amount of the required minimum remittance and the due date are requirements that the Postal Service must meet to continue to receive retirement rate adjustment authority. These required minimum remittances and due dates do not affect the Postal Service's statutory obligations to make the full amortization payment as determined by OPM.

competitive products) make the full amortization payment. In the example, the phase-in period lasts from FY 2021 to FY 2025. For illustration purposes, consider the final calculation of retirement rate authority in FY 2025. Under Formula IV-1, the first step is to divide the total amortization payment for FY 2024 by the total revenue for that year (FY 2024 data will be the most recent available at the time of the FY 2025 calculation). From Table IV-5, those values are \$3.4 billion and \$73.9 billion, respectively. Dividing these two figures shows that, had no previous retirement rate authority been authorized, total revenue would need to increase by 4.600 percent to be able to make the full amortization payment. Because retirement rate authority was granted in 4 previous years, the second step is to subtract the compounded amount of that increase, calculated with Formula IV-2, and shown in Table IV-6. For FY 2025, that amount is 3.631 percent. Because FY 2025 is the last year of the phase-in period, the 0.970-percentage point difference between 4.600 percent and 3.631 percent does not need to be further amortized, and thus 0.970 percent is the amount of retirement rate authority for FY 2025, as shown in Table IV-6.

To calculate the required minimum remittance for FY 2025, Formulas IV-3 and IV-4 calculate the percentage of Market Dominant revenue collected in FY 2024 as a result of previously authorized retirement rate authority. As shown in Table IV-7 (on the line corresponding the year of calculation, FY 2025), that amount is 2.643 percent. This is lower than the 3.631 percent compounded rate authority figure used in the previous paragraph because the 1.111-percent retirement rate authority authorized in FY 2024 was not used until the last month of FY 2024 (as shown in Table IV-6), and thus generated very little additional revenue in FY 2024. Multiplying 2.643 percent by the FY 2024 Market Dominant revenue of \$48.011 billion (shown in Table IV-5) produces a minimum required remittance for FY 2025 of \$1.269 billion, as shown in Table IV-7.

The Postal Service is responsible for funding retirement benefits for its employees. OPM determines the annual payment for these obligations. The

Commission, through the new rate authority is giving the Postal Service the ability to begin funding its retirement benefit obligations in the future.

V. PERFORMANCE-BASED RATE AUTHORITY

A. Introduction

In the NPR, the Commission sought comments on its proposal to allocate up to 1 percentage point of additional performance-based rate authority for each class of mail. Order No. 4258 at 53, 130. This proposed additional rate authority was to be conditioned upon meeting or exceeding an operational efficiency-based standard and maintaining a service-based standard. *Id.* at 55. Of the 1 percentage point of rate authority, 0.75 percentage points was proposed to be allocated based on the operationally efficiency-based standard, and 0.25 percentage points was allocated based on the service-based standard. *Id.* at 56. This performance-based rate authority would lapse if not used within the calendar year and could not be used to generate unused rate authority or affect existing banked rate authority. *Id.* at 120.

A specific TFP growth target was proposed as the benchmark for the operational efficiency-based standard. *Id.* at 57. Under this proposal, the Postal Service would be allocated the 0.75 percentage points of additional rate authority if the Postal Service's "average annual TFP growth over the most recent 5 years met or exceeded 0.606 percent." *Id.* at 61-62, 120. This would be determined in the most recent ACD. *Id.* at 120.

Any reduction in service standards was proposed as the benchmark for the service-based rate authority. *Id.* at 70-71. Under this proposal, the Postal Service would be allocated the 0.25 percentage points of additional rate authority if "all of the Postal Service's service standards (including applicable business rules) for that class for the applicable year met or exceeded the service standards in place during the prior fiscal year on a nationwide or substantially nationwide basis." *Id.* at 71. This would also be determined in the most recent ACD. *Id.* at 120-121. In addition, for the determination regarding the service standards, interested persons would be permitted to

challenge the Commission's determination within 30 days of the issuance of the ACD. *Id.* at 121.

Based on the comments received by the Commission, several changes were made to the original proposed performance-based rate authority. Instead of creating two smaller, independent incentives for operational efficiency and maintenance of service standards, these performance areas were combined into 1 percentage point of additional rate authority granted when both efficiency and service benchmarks are achieved. Additionally, the efficiency benchmark was altered from a rolling 5-year average TFP growth to year-over-year TFP growth in order to make the efficiency measure more representative of recent Postal Service efficiency gains.

The purpose of the proposed performance-based rate authority in Order No. 4258 and in this Revised NPR is to promote greater capital investment and allow the Postal Service to reenter the financial health cycle by providing the Postal Service with additional revenue if it achieves the specific operational efficiency and service standard benchmarks. The financial health cycle requires the generation of "adequate revenues to ensure net income, which provide retained earnings." *Id.* at 46. The Commission discussed how the financial health cycle broke down during the PAEA era and determined that Objectives 1, 3, and 5 were intended to function harmoniously within this cycle.¹⁷⁹ As the Commission explained:

Retained earnings enable the Postal Service to make the kinds of capital investments needed to improve operational efficiency. Capital investments that improve efficiency will also likely lead to cost reductions and help maintain high quality service standards. Maintenance of high quality service standards promotes demand for postal products, which leads to increased revenue. Increased revenue and decreased costs lead to sustained net incomes, which results in retained earnings.

¹⁷⁹ Objective 1, "maximize incentives to reduce costs and increase efficiency;" Objective 3, maintain high quality service standards; and Objective 5, attain "adequate revenues, including retained earnings." See *id.* (quoting 39 U.S.C. § 3622(b)(1), (3), and (5)).

Order No. 4258 at 46.

Consecutive net losses during the PAEA era have resulted in an accumulated deficit rather than retained earnings. *Id.* at 47. The Postal Service hit its debt ceiling in FY 2012 and, without retained earnings or borrowing authority, now struggles to finance capital investments. The Commission discussed how the vast net losses and accumulated deficit throughout the PAEA era, coupled with the maximization of its borrowing authority, corresponded to drastic decreases in the Postal Service's capital outlays. *Id.* at 49-51.

Ultimately, the Commission concluded that this "sharp decline in capital investments contributed" to the failure to achieve Objectives 1, 3, and 5. *Id.* at 52. As the foregoing analysis in Order No. 4258 explained, the Postal Service's accumulated deficit and lack of borrowing authority during the PAEA era "severely restricted the Postal Service's ability to make capital improvements." *Id.* at 50. The performance-based rate authority is based on the concept that without retained earnings, the Postal Service is unable to finance the capital investments necessary to sustain its financial health cycle. *Id.* at 47. Accordingly, the performance-based rate authority is intended to act as a mechanism that the Postal Service can use to reenter the financial health cycle and achieve the objectives of the PAEA.

B. Comments

The Commission received numerous comments on the performance-based rate authority proposal. Comments generally fall into two groups: those that support the additional performance-based rate authority with modifications and those that reject the additional authority for a variety of reasons ranging from disagreement with the Commission's justification to disagreement with the methodology to measure and apply the additional rate authority. Generally, commenters focused on the justification for the

authority, the amount of authority, the choice of the benchmarks, weighting of the benchmarks, and the effect of the proposal.

The Commission analyzes the relevant comments topically and provides its analysis and any corresponding modifications to the proposed rules below.

C. Commission Analysis

1. Justification for Performance-Based Rate Authority

The Commission received and considered comments regarding the justification for the performance-based rate authority. Specifically, comments were received regarding the Commission's discussion of the financial health cycle and the need for retained earnings, the conditional nature of the additional authority, and the performance-based rate authority as an incentive. The Commission summarizes and responds to those comments below.

Comments on the financial health cycle. The Commission received numerous comments regarding its analysis that Objectives 1, 3, and 5 failed to operate harmoniously in the financial health cycle and that additional revenue is necessary to allow the Postal Service to reenter the financial health cycle for long-term financial stability.

Some commenters submit that the Commission is correct to point out the failure of the financial health cycle and the resulting need for additional capital investments as justification for the proposed performance-based rate authority. The Postal Service notes that the financial health cycle proposed by the Commission "correctly identifies the problem that operational efficiency will lag at the beginning of the new system, due to inadequate capital investment levels, and posits that operational efficiency may rise during the period as a result of capital investments in the early years." Postal Service Comments at 104. Although discussing additional rate authority in general and not

specifically the performance-based proposal, Valpak also agrees that the Commission correctly “identified the task at hand” to provide additional rate authority “in a manner that will put the Postal Service on the path to generating sufficient revenue to meet its medium-term obligations balancing all of the PAEA’s objectives.”¹⁸⁰

In contrast, numerous commenters disagree with the Commission’s conclusions regarding the financial health cycle and dispute the idea that retained earnings are necessary to make capital investments or increase efficiency. In rejecting the reliance on the financial health cycle, ANM *et al.* disagree with the concept that retained earnings are necessary for capital investments, as the Postal Service “can fund capital investments so long as it is meeting the Commission’s definition of *short term* financial stability.”¹⁸¹ In addition to only needing to be stable in the short term to make capital investments, ANM *et al.* further claim that the Commission has not demonstrated any capital shortfall to justify its proposed additional rate authority and has not conducted the necessary analysis to determine whether such a shortfall exists. ANM *et al.* Comments at 45. In their reply comments, ANM *et al.* dispute the Postal Service’s contention that it “cannot increase operational efficiency without additional revenue.” ANM *et al.* Reply Comments at 49. ANM *et al.* claim that “[the Postal Service’s] current inefficiency is not the result of a lack of capital, and its future efficiency growth is not dependent on additional capital.” *Id.*

NPPC *et al.* also disagree with the concept that additional rate authority is needed to fund capital investments. NPPC *et al.* claim that the Postal Service has not

¹⁸⁰ Valpak Comments at 10 (quoting Order No. 4258 at 41) (internal marks omitted).

¹⁸¹ ANM *et al.* Comments at 43 (emphasis in original). To support their claim, ANM *et al.* contend that the “Postal Service managed to make capital investments in efficiency and cost reduction during 1971-2007, when the breakeven requirement of the Postal Reorganization Act [(PRA)] forbade the Postal Service from retaining earnings as a matter of law[]” demonstrates that “investments do not require retained earnings.” *Id.* at 44. In response, the Postal Service contends that the “breakeven requirement effectively guaranteed that capital investments would be funded from year to year (or rate case to rate case) as operating expenses to be recovered in rates.” Postal Service Reply Comments at 75 n.200.

been held accountable for its past capital investment decisions because “there is no systematic Commission process to review or to assure that its capital investments are prudent, or that they even achieve the targeted return on investment presented in the Decision Analysis Reports that underlie the authorization of those investments.” NPPC *et al.* Comments at 13. NPPC *et al.* suggest that the Commission modify the proposed rule to require that any additional rate authority be conditioned on actual improvements and “require the Postal Service to seek prior approval of any capital investment that it would fund with extra cap authority.” *Id.* at 17.

Similarly, APWU proposes that rather than an efficiency benchmark for additional rate authority, the Commission should conduct a review of the Postal Service’s capital investment and outlay plans for the applicable fiscal year.¹⁸² The Public Representative states that he considers the APWU proposal to link any additional rate authority to specific capital plans as superior to the Commission’s proposal. PR Reply Comments at 21. Netflix asserts that the Commission should refrain from imposing “any additional increase to fund capital investment until it has compiled an adequate record on investment needs.”¹⁸³

In its reply comments, the Postal Service objects to any modification to the proposal that would require a determination regarding its capital investment and outlay plans or a year-by-year cost-tracking process. Postal Service Reply Comments at 82. The Postal Service states that any process, as suggested by APWU and ANM *et al.*, “to condition the rate authority on a prudence review of the Postal Service’s specific investment plans” would “imbue the new system with the regulatory burden, inflexibility, and uncertainty of cost-of-service ratemaking litigation.” *Id.* Further, under APWU’s

¹⁸² Comments of the American Postal Workers Union, AFL-CIO on the Notice of Proposed Rulemaking for the System for Regulating Rates and Classes for Market Dominant Products, March 1, 2018, at 19 (APWU Comments).

¹⁸³ Reply Comments of Netflix Inc., March 30, 2018, at 19 (Netflix Reply Comments).

proposal, the Postal Service would not know the amount of annual rate authority until “after the Postal Service files its request with an annual spending plan, and after that plan has been litigated before the Commission.” *Id.* The Postal Service states that the optimal modification to the Commission’s proposal is “to make the additional rate authority unconditional until the next Section 3622(d)(3) review or, at a minimum, for the first year or two, until a more methodologically sound TFP-based mechanism can take effect.” *Id.* at 82-83.

Comments on the conditional nature of the performance-based rate authority.

The Commission also received comments regarding the proposal to condition any additional rate authority under this section on the achievement of specific operational efficiency and service standard benchmarks.

In general, the Postal Service supports the use of additional rate authority to encourage efficiency gains and agrees that it requires the additional rate authority so that it can make investments necessary to achieve the desired efficiency gains. Postal Service Comments at 6, 83-84. However, it disagrees that the additional authority should be conditioned upon meeting certain TFP metrics. *Id.* at 81. As the performance-based rate authority is currently proposed, the Postal Service contends that it cannot attain the additional rate authority it needs to make these investments to achieve efficiency gains unless it “shows efficiency gains *first*.” *Id.* at 83 (emphasis in original). As a modification, the Postal Service proposes that the additional rate authority be provided without any conditions or performance requirements. *Id.* at 81.

NPMHU agrees with the Postal Service that the proposed performance-based rate authority puts the Postal Service in a catch-22 situation where “it cannot make significant efficiency gains without capital investments, but it cannot get additional efficiency-based rate authority that could fund capital investments until it makes significant efficiency gains.” NPMHU Comments at 6. Similarly, APWU submits that additional revenue is needed for reinvesting in the network and agrees that requiring

efficiency improvements without access to capital first is putting the cart before the horse. APWU Comments at 14-15. NALC expresses the same sentiment and contends that the Commission has failed to explain how the Postal Service, without first having the needed funds, “could achieve the operational improvements required to increase efficiency.” NALC Comments at 15-16.

In contrast, some commenters object to any proposal to make the additional rate authority unconditional for capital investments. See, e.g., Netflix Reply Comments at 18. ANM *et al.* also disagree with the Postal Service’s suggestion that the additional 1 percentage point of rate authority be provided unconditionally and claim that the Postal Service’s proposal would fail to “provide an incentive to do anything.” ANM *et al.* Reply Comments at 53. NPPC *et al.* respond that the cart before the horse argument is invalid, as the Postal Service already has funds, “more than \$10 billion in cash reserves on hand,” to commit to capital investments. NPPC *et al.* Reply Comments at 38.

Comments on the performance-based rate authority as an incentive.

Commenters diverge on whether the performance-based rate authority would act as an incentive to increase efficiency. United Parcel Service, Inc. (UPS) supports the proposed performance-based rate authority in general and “agrees that performance-based incentives are an appropriate means of assuring that the Postal Service not lose sight of the statutory objectives, or otherwise take advantage of its captive market dominant customers.”¹⁸⁴ Valpak submits that incentives during the PAEA era “have not been sufficient to generate increases in productivity” and that tying any additional rate authority to performance-based requirements is necessary to provide a greater incentive. Valpak Comments at 8, 10-11.

Contrary to the Commission’s proposal, certain commenters contend that the proposed additional performance-based rate authority would not serve as an incentive

¹⁸⁴ Comments of United Parcel Service, Inc., March 1, 2018, at 4 (UPS Comments).

to increase efficiency. Although the Postal Service agrees that additional funds for capital investments are necessary, it cautions that conditioning the authority on meeting specific TFP benchmarks could provide the wrong incentives.¹⁸⁵ Netflix submits its concern whether the “Commission’s proposed rate cap provides adequate incentive to improve performance, and the [performance-based rate authority] will simply introduce extraneous signals that interfere with the proper functioning of the cap system.” Netflix Comments at 24. Netflix also contends that TFP is not a suitable measure because it could decline in response to investments and could “be quite discouraging to the Postal Service – and even a disincentive – to watch efficiency decline as it makes investments.” *Id.* at 23. Discover Financial Services (DFS) agrees with Netflix that the performance-based rate authority “conflicts with basic price cap principles and is unworkable.”¹⁸⁶

ANM *et al.* contend that the proposed performance-based rate authority would reduce the incentives to increase efficiency and decrease costs because it is another proposal to loosen the price cap. ANM *et al.* Comments at 48-57, 84. Based on their review of historical data, they state that “[d]eclines in Postal Service productivity growth historically have corresponded with periods during which the Postal Service had access to revenue above the CPI cap.” *Id.* at 48. ANM *et al.* state that “[t]he reduction in incentives created by loosening the price cap cannot be remedied by” conditioning additional authority on performance. *Id.* at 52-57.

¹⁸⁵ Postal Service Comments at 88-89. The Postal Service claims that tying TFP to capital investments could incentivize management to avoid certain investments that would either not have an effect on TFP or cause it to decrease, like investments in mail-security technology, cybersecurity, and customer service. *Id.* The Postal Service states that this focus on TFP could cause it to “defer needed investments in mail security and other areas that would benefit the public” and work to the detriment of Objective 7 (enhance mail security and deter terrorism). *Id.* at 89.

¹⁸⁶ Reply Comments of Discover Financial Services, March 30, 2018, at 5.

Certain commenters also claim that the proposed performance-based rate authority fails to act as an incentive because it does not consider Postal Service costs.¹⁸⁷ The Public Representative states that the additional performance-based rate authority provides *de minimis* incentives. PR Comments at 4.

Commission analysis. The Commission first addresses comments that dispute the need for retained earnings in order to make capital investments and reenter the financial health cycle. The majority of the arguments raised in the comments do not address the financial reality facing the Postal Service and instead appear to attempt to limit any additional rate authority regardless of whether it is necessary to achieve the objectives of the PAEA. Certain commenters focus on whether or not the proposal achieves individual objectives of the PAEA, as opposed to viewing the objectives of the PAEA as they operate in conjunction with the others.

As detailed in Order No. 4258, the proposed performance-based rate authority is targeted to address three interrelated deficiencies of the PAEA ratemaking system: the failure to achieve financial stability, including retained earnings; the failure to maximize incentives to reduce costs and increase efficiency; and the failure to encourage the maintenance of high quality service standards. Order No. 4258 at 46-47. By proposing a performance-based incentive in the form of additional rate authority, the Commission intends for the ratemaking system to better achieve Objectives 1, 3, and 5 and provide a mechanism for the Postal Service to reenter the financial health cycle.

As explained by the Commission, in an ideal situation, the Objectives 1, 3, and 5 would function in a harmonious cycle that “begins with the path to financial stability.” *Id.* at 46. To start, a “financially healthy Postal Service generates adequate revenues to

¹⁸⁷ See Comments of the Software & Information Industry Association, March 1, 2018, at 8 (The proposed rules “would create a system where the Postal Service can increase rates to enable cost coverage, including long-term capital expenditures, regardless of what these costs are.”); Comments of the American Mail Alliance, March 1, 2018, at 5 (The “proposal from the Commission does not compel or incentivize the Postal Service to reduce costs.”).

ensure net income, which provide retained earnings.” *Id.* The retained earnings then allow the Postal Service to invest in capital improvements to increase operational efficiency, which should lead to cost reductions and help maintain service standards. *Id.* Within this cycle, the increased efficiency and maintenance of high quality service standards should result in increased revenue. *Id.* at 46-47. Combined with decreased costs and this increased revenue, the cycle generates retained earnings. *Id.* at 47. In addition, “[a] related but separate component to this cycle is borrowing. Retained earnings can be used to pay down debt and borrowing can be used to finance capital investments.” *Id.*

The Commission found that the cycle broke down during the PAEA era, leading to an accumulated deficit and lack of borrowing authority as opposed to retained earnings. *Id.* at 47-50. As the Commission stated in Order No. 4257, “[i]f an entity accumulates net losses instead of net income, the result is an accumulated deficit rather than retained earnings. This can restrict the ability to fund capital improvements and often leads to an increase in the use of debt.” Order No. 4257 at 170. The break-down of the financial cycle has led to a severe restriction in the Postal Service’s ability to make capital investments. Order No. 4258 at 50.

The proposed performance-based rate authority balances the need for the Postal Service to reenter the financial health cycle with the obligation to increase efficiency and maintain high quality service standards. Although the Commission has determined that this additional revenue is required in order to ensure the Postal Service’s long-term financial stability, this revenue is not guaranteed without specific action by the Postal Service. By obligating the Postal Service to focus its efforts on efficiency gains that increase TFP and maintain its service standards, the proposal acts as both an incentive and a control on the Postal Service’s access to and use of any additional funds.

Although commenters are correct that the Postal Service was able to make capital investments during the PAEA era despite failing to attain retained earnings, the

Commission determined that “[a]s its accumulated deficit increased, the Postal Service began to decrease its capital commitments and subsequent outlays.” *Id.* at 50. This overall sharp decline in capital investments contributed to the “lack of financial stability, insufficient levels of efficiency gains and cost reductions, and inability to adequately encourage the maintenance of service standard quality.” *Id.* at 52. As previously explained, “[t]o maintain financial stability, the ratemaking system must enable the Postal Service to ‘assure adequate revenues, including retained earnings,’ as required by Objective 5.”¹⁸⁸ As a result of the failure to generate retained earnings during the PAEA era, “long-term stability was not maintained.” Order No. 4257 at 171. The fact that the Postal Service was able to make some capital investments throughout the PAEA era does not render void the fact that retained earnings are a necessary part of the overall financial health cycle. As previously stated, “[a]fter balancing the objectives of the ratemaking system, the Commission determines that the best course of action is not to provide the Postal Service a specific level of retained earnings or a set amount of funding for capital investment but rather to put the Postal Service on a path to long-term financial stability while providing meaningful incentives for the Postal Service to increase operational efficiency and maintain high quality service standards.” Order No. 4258 at 53. Therefore, the Commission maintains the failure of the financial health cycle and analysis provided in Order No. 4258 provide sufficient justification for conditioning additional rate authority on meeting specific performance-based requirements.

Commenters seeking an unconditional provision of additional performance-based rate authority are primarily concerned with the Postal Service’s ability to achieve efficiency gains without first having the funds to invest in capital, the “cart before the horse” issue. These concerns fail to take into account the other proposed modifications to the ratemaking system in addition to the additional performance-based rate authority

¹⁸⁸ Order No. 4258 at 46 (citing Order No. 4257 at 147).

proposal. Prior to conditioning any additional rate authority on performance, the Commission originally proposed providing additional supplemental rate authority that would put the Postal Service on the path to medium-term financial stability.¹⁸⁹

The performance-based rate authority is intended to function in addition to the modifications to the system as a whole, and is intended to work as an incentive to increase efficiency and encourage the maintenance of high quality service standards in addition to putting the Postal Service on the path to long-term financial stability. *Id.* at 53. The Commission maintains that it is not necessary or desirable to provide the performance-based rate authority unconditionally, as one of the goals of the performance-based rate authority is to maximize incentives for the Postal Service to reduce costs and increase efficiency. The availability of separate supplemental authority to address medium-term financial stability will also allow the Postal Service to focus its cost savings efforts on reaching the targeted benchmarks for efficiency and service under the performance-based rate authority. Accordingly, the Commission has considered the comments and declines to modify the proposal to make the performance-based rate authority unconditional. If the Postal Service cannot make improvements to efficiency and maintain service standards with available resources as a result of the proposed modifications to the ratemaking system, then it should not have access to any additional authority under the performance-based rate proposal. The performance-based rate authority will remain conditioned upon meeting both an operational metric and a service metric as detailed further below.

With respect to the issue of whether there needs to be a specific demonstrated shortfall or review of the Postal Service's capital investment plans prior to providing any additional funds for capital investments, the Commission declines at this time to

¹⁸⁹ *Id.* at 35-43. Although this supplemental rate authority is modified in this Revised NPR, the principle remains that the Postal Service will gain additional rate authority every year that is not conditioned upon first meeting performance-based metrics.

condition the additional rate authority on the Postal Service's capital investment plans. In Section VIII.D., the Commission proposes reporting requirements to monitor Postal Service cost reduction efforts, as well as increase the transparency of certain Postal Service projects. However, the Commission does not seek to assert its regulatory authority over the Postal Service's operational decisions at this point in time. Instead of substituting its judgment for the operational expertise of the Postal Service over its own operations, the Commission requires the Postal Service to meet a performance-based benchmark based on an operational efficiency and service metric. The metrics would provide the Commission with the means to determine whether the performance-based rate authority had increased the Postal Service's ability to achieve Objectives 1, 3, and 5, in conjunction with the other objectives and factors of 39 U.S.C. § 3622. The Commission is satisfied that the performance-based conditions on the additional rate authority provide both a sufficient incentive and control on the Postal Service's use of funds to make capital investments that will be focused on increasing efficiency and maintaining high quality service standards.

In response to commenters who contend that the performance-based rate authority does not provide an incentive to increase efficiency and encourage the maintenance of high quality service standards, the Commission disagrees. Specifically, commenters are incorrect in their contention that the additional rate authority and ability to invest in capital do not provide an incentive to make efficiency improvements. As the Commission determined, the Postal Service requires additional revenue in order to have a sustainable future and achieve financial stability. See *generally* Order No. 4258 at 27-55. Therefore, having determined that additional revenue is required, the proposed performance-based rate authority serves as an incentive for the Postal Service to gain that additional revenue by first meeting the specific efficiency and service benchmarks. Because the performance-based rate authority is conditional and not guaranteed, the Postal Service is forced to examine its operations in order to evaluate opportunities to

increase efficiency. Prudent business decisions that will increase efficiency will result in the availability of additional rate authority to support capital investments.

Moreover, the conditional nature of the performance-based rate authority is intended not only to act as an incentive for the Postal Service to increase efficiency and maintain service standards, but to act as a control on its ability to gain extra revenue from ratepayers. As another protection for ratepayers, the Postal Service must first show efficiency gains without the benefit of having 1 percentage point of rate authority before any additional authority under this proposal is granted. Although there are many different types of incentive programs available, the Commission believes that the potential for the Postal Service to gain this additional rate authority will result in greater effort on its part to realize efficiency gains and maintain high quality service standards.

2. Amount of Authority

Comments were received regarding the Commission's determination that up to 1 percentage point of rate authority would be provided under the performance-based rate authority proposal. Commenters present different views on the use of the pre-PAEA level of capital investments as part of the benchmark and the appropriate amount of additional performance-based rate authority. The Commission summarizes and discusses those comments below.

Comments. Numerous commenters disagree with the Commission's use of pre-PAEA investment levels as one of the factors it considered to set the performance-based rate authority at 1 percentage point. Specifically, commenters contend that the level of pre-PAEA capital investments would be too high for a variety of reasons. Commenters claim that there is no evidence provided to conclude that the pre-PAEA investment levels are appropriate "or that the same level of investment is necessary in

the current environment.”¹⁹⁰ ANM *et al.* contend that there is no basis to restore the Postal Service’s capital investment levels to the pre-PAEA level where the Postal Service is operating in a declining volume environment.¹⁹¹ Similarly, NPPC *et al.* assert that “the Commission cannot assume that the level of capital investment [for 2006] is optimal or appropriate for the smaller entity today.” NPPC *et al.* Reply Comments at 34.

ANM *et al.* also suggest that capital expenditure could be expected to decline under the PAEA as the “price cap was intended in part to force the Postal Service to more carefully consider its capital expenditures and eliminate wasteful projects.” ANM *et al.* Comments at 47. NPPC *et al.* agree “that a lower level of capital investment today under a price cap system than in the last year of cost-of-service regulation is not surprising.” NPPC *et al.* Reply Comments at 33.

Although the Public Representative agrees that additional capital investment is needed, he contends that the 1 percentage point of performance-based rate authority should be based on future capital needs as opposed to attempting to return to 2006 capital investment levels. PR Comments at 30-31. Netflix agrees with the Public Representative’s view and contends that it is misguided to attempt to “return the Postal Service to investment levels of the past and to the same level of net asset holdings as in the distant past of FY 2006.”¹⁹² Netflix also proposes that any need for investment should be supported by an “expected [return on investment] for each project and proving that the investment is critical and current in light of shrinking volumes and the changing market environment.” Netflix Reply Comments at 18.

¹⁹⁰ ANM *et al.* Comments at 46; *see also* NPPC *et al.* Reply Comments at 34.

¹⁹¹ ANM *et al.* Comments at 40; *see also id.* at 44-45.

¹⁹² Netflix Reply Comments at 17 (quoting PR Comments at 31) (internal marks omitted).

Numerous other commenters contend that the additional authority is not enough to achieve long-term financial stability.¹⁹³ NALC states that the “Commission correctly recognizes that to achieve long-term financial stability, USPS must generate sufficient net income year after year to generate retained earnings, which can then be used to invest in capital improvements and pay down debt.” NALC Comments at 13. NALC claims that the pre-PAEA levels of capital outlays “would not provide USPS with long-term financial security” because the Postal Service claimed in 2006 that it had insufficient capital expenditures.¹⁹⁴ NALC submits that during the entire PAEA era, the Postal Service had a complete lack of working capital which “prevented USPS from spending as needed to repair, maintain and upgrade its operations.” NALC Comments at 14. NALC notes that “[w]hile USPS had substantially higher revenue than both UPS and [Federal Express Corporation (FedEx)] from FY 2006 to 2014, its total capital expenditures, \$13 billion, fell well behind FedEx’s \$25.5 billion and UPS’s \$18.5 billion.”¹⁹⁵

With respect to the impact of volume on the proposed 1 percentage point of performance-based rate authority, NALC contends that the Commission’s analysis for the 1 percentage point of additional performance-based rate authority is flawed where it

¹⁹³ See, e.g., NALC Comments at 13; Postal Service Comments at 80-81; PR Comments at 35. Specifically, the Public Representative submits that the 0.75 rate authority for efficiency gains is not enough to “move the Postal Service away from financial instability.” PR Comments at 35; Declarations in Support of the Comments of the Public Representative, March 1, 2018, file “Decl. of Lyudmila Y. Bzhilyanskaya.pdf,” at 6 (Bzhilyanskaya Supplemental Declaration). The Postal Service submits that not only is the additional 1 percentage point of pricing authority insufficient as combined with the proposed supplemental rate authority to provide the retained earnings necessary for capital investment. Postal Service Comments at 80-81. NALC also submits that the additional performance-based rate authority amount of 1 percentage point “would not be enough for USPS to achieve long-term financial stability.” NALC Comments at 13.

¹⁹⁴ *Id.* at 16 (citing United States Postal Service, Annual Report 2006, at 34, available at: <http://about.usps.com/who-we-are/financials/annual-reports/fy2006.pdf>).

¹⁹⁵ *Id.* (citing United States Postal Service, Office of Inspector General, *Peeling the Onion: The Real Cost of Mail*, Report No. RARC-WP-16-009, April 18, 2016, at 2, available at: <https://www.uspsaig.gov/sites/default/files/document-library-files/2016/RARC-WP-16-009.pdf> (RARC-WP-16-009)).

assumes that “market dominant mail volumes will remain constant.” NALC Comments at 15. The Public Representative also critiques the proposed performance-based rate authority for failing to analyze the “potential impact that volume declines will have upon efficiency gains in the future.” PR Comments at 35.

Commission analysis. After balancing the objectives of the ratemaking system, the Commission proposed a maximum of 1 percentage point of additional authority to be designated as the performance-based rate authority. This 1 percentage point of additional rate authority was not intended to provide the Postal Service a specific level of retained earnings or a set amount of funding for capital investment but rather to address deficiencies in the Postal Service’s long-term financial stability and provide incentives for the Postal Service to increase operational efficiency and maintain high quality service standards. Order No. 4258 at 53. In determining the amount of performance-based rate authority, the Commission used several reference points related to capital investment, capital assets, and borrowing authority. *Id.* at 39. Commenters present diverging views on the appropriate amount of performance-based rate authority, with some claiming the 1 percentage point is too high and others contending the number is too low. Many commenters focus on the level of capital investment that was made during the pre-PAEA cost of service regime.¹⁹⁶ The pre-PAEA level of investment by the Postal Service reflects the best available estimate of the Postal Service’s general level of capital expenditures and is but one of the reference points used in the Commission’s determination to set the appropriate amount of performance-based rate authority at 1 percentage point.

The Commission’s proposed rule is not simply intended to return the Postal Service to its pre-PAEA levels of capital investment, as the amount of capital outlays during that timeframe only served as one reference point for the Commission’s analysis.

¹⁹⁶ During the PRA era, the capital investments were included in operational expenses that were funded by ratepayers.

The 1 percentage point of authority was derived by taking into account multiple reference points, including the amount of capital spending and the value of assets pre-PAEA compared to post-PAEA and the amount of borrowing authority exhausted during the PAEA era. *Id.* at 54. The Commission explained, “[t]aking into account these reference points, the impact of the proposed supplemental rate authority, and the rate increases experienced during the PAEA era, the Commission applies its expert judgment in postal matters to determine that 1 percentage point per annum is the appropriate amount of performance-based rate authority.” *Id.* Therefore, the Commission’s proposal is not simply based on an analysis of pre-PAEA capital spending levels.

Certain commenters submit that the appropriate amount of performance-based rate authority should be based on future capital needs. As stated previously, the Commission declines to conduct a capital investment review process, as the performance-based rate authority provides a mechanism for the Postal Service to receive needed revenue that is conditioned on performance metrics. It is purposefully designed to allow operational flexibility and avoid interference in the Postal Service’s business decisions. Accordingly, at this time, the Commission declines to conduct any review or assessment of the individual capital requests or decisions by the Postal Service which would necessitate a subjective evaluation of the Postal Service’s business decisions. As discussed in Section VIII.D., in order to provide additional transparency, the Commission is proposing rules to monitor and provide public visibility into the Postal Service’s efforts to reduce costs. The proposed reporting by the Postal Service will be monitored by the Commission in order to assess the Postal Service’s compliance with the direction in Objective 1 to reduce costs and increase efficiency.

The Commission appreciates commenter concerns that the 1 percentage point of performance-based rate authority is either too high or too low and that there are exogenous factors that the Commission did not account for in determining the amount of performance-based rate authority. However, the Commission's proposed performance-based rate authority is not meant to act in isolation. The proposed rules, on the whole, will provide the Postal Service with the tools and incentives necessary to address the deficiencies in the ratemaking system. As the proposed rules act as a mechanism to achieve the objectives of the PAEA, it is up to the Postal Service to use the tools and incentives provided to it in order to successfully achieve those objectives in the future.

In addition, as explained previously, the performance-based rate authority is conditioned upon the Postal Service meeting specific efficiency and service standard benchmarks. Not only does this condition provide an incentive to increase efficiency and maintain high quality service standards, it also acts as a more objective measure of the quality of the Postal Service's capital investments. As the Commission previously stated, the proposed performance-based rate authority includes "performance requirements that must be met prior to additional funding becoming available to further the long term financial stability of the Postal Service."¹⁹⁷ As a result, "[t]hese requirements incentivize the Postal Service to put future capital expenditure to good use[.]" Order No. 4397 at 5.

As proposed, the performance-based rate authority is not required to be used or exhausted by the Postal Service. The Postal Service must determine the appropriate level of capital investment then, if available, designate the amount of performance-based rate authority to appropriately balance all of the objectives. For example, when using the rate authority granted by the proposed rules, the Postal Service must consider

¹⁹⁷ Order Denying Motion for Issuance of Information Request, February 6, 2018, at 5 (Order No. 4397).

the impact of the rate increases on mailers consistent with all of the statute and the principles of the PAEA. In addition, the Postal Service must exercise business judgment to determine the appropriate level of rate increases in light of various considerations, including the effect on mail volumes.

The Commission agrees with NALC's point that the Postal Service's capital expenditures fell well behind those of its competitors. The Commission also notes that depreciation and amortization trends for the Postal Service exceed capital expenditure for all years between 2008 and 2016.¹⁹⁸ Such long-term trends are unsustainable and will further contribute to the deterioration of the Postal Service's operations unless additional revenue is generated to allow the Postal Service to reenter the financial health cycle. The Commission also recognizes that NALC and the Public Representative are correct that the proposed performance-based rate authority does not factor in the effect of growth or declines in Market Dominant mail volume and that mail volume changes will affect the actual amount of revenue generated by the additional 1 percentage point of rate authority. The Commission has determined that it is the Postal Service's responsibility to modify its operations in response to any mail volume changes. The proposed system modifications are providing the Postal Service with a mechanism and the opportunity for change, not a solution to every problem that may arise. Accordingly, the Postal Service will not earn any additional performance-based rate authority if it is unable to achieve efficiency gains in response to changes in mail volume. As explained above, the performance-based rate authority is intended to promote long-term financial stability over time and is not intended to be considered in isolation without consideration of the supplemental rate authority and other proposals.

¹⁹⁸ See Docket No. ACR2016, Financial Analysis of United States Postal Service Financial Results and 10-K Statement, Fiscal Year 2016, March 31, 2017, at 32, 34; RARC-WP-16-009 at 16.

Therefore, the Commission maintains that 1 percentage point of rate authority is the appropriate amount of additional rate authority under this proposal and declines to modify the amount of performance-based rate authority. The Commission will monitor the function of the performance-based rate authority for 5 years and will review the effects of the additional authority at that time to determine whether an increase or decrease in the amount of authority is appropriate in the future.

3. Operational Efficiency Benchmark for Performance-Based Rate Authority

The Commission received several comments regarding the use of TFP as the benchmark for the operational efficiency component of the performance-based rate authority. Comments were received regarding the utility of TFP as a benchmark metric in general, and on the application and measurement of TFP to determine whether the operational efficiency component of the performance-based rate authority was achieved. The Commission reviews the comments and provides its response below.

Comments on use of TFP in general as benchmark. Numerous comments were received disagreeing with the use of TFP as the benchmark measure of operational efficiency. The Postal Service disagrees with the proposal to use TFP as the benchmark, contending that TFP is affected by numerous factors beyond its control and it is “weighted down by past underinvestment and the increasingly limited opportunities for future efficiency improvement within statutory constraints.” Postal Service Comments at 86.

The Postal Service claims that it is problematic to use TFP to measure operational efficiency increases based on capital investments because capital investments are not reflected in TFP growth in the short term. *Id.* at 86-88. The American Catalog Mailers Association, Inc. (ACMA) and the Parcel Shippers Association (PSA) share the Postal Service’s concerns about the appropriateness of

TFP as an indicator of efficiency gains in the short term.¹⁹⁹ Further, the Postal Service contends that as “[c]apital is an element of the resource-usage or input component of TFP[,]” an increase in capital expenditures in 1 year may cause TFP to decline in that year. Postal Service Comments at 87.

Other commenters critique the use of TFP as a benchmark for different reasons. NPPC *et al.* claim that TFP is an imperfect measure “because the way it measures efficiency allows TFP to increase without costs decreasing if there is excessive inflation in factor input prices.” NPPC *et al.* Comments at 69. NPPC *et al.* express concern that the use of TFP as a benchmark “would give the Postal Service a direct incentive to shift postal costs onto mailers without offering workshare or other incentives.” *Id.*

UPS proposes that the Commission develop separate TFP measures for Market Dominant and Competitive mail. UPS notes its concern that “TFP measures raw output per input, but does not measure the profitability of that output[,]” which gives the Postal Service “an incentive to cut competitive products rates below profit-maximizing levels to drive up competitive product volume, and thus TFP, in order to unlock the performance-based rate authority.” UPS Comments at 7.

UPS suggests that “[i]t should be a simple matter for the Postal Service to disaggregate the TFP figures for the two enterprises” and that it “would only be necessary to replace the total labor, total capital and total material categories upon which the current TFP measure is based with figures derived from the segments and components set forth in the annual ACD filing, and make a few necessary adjustments to the formula inputs.” *Id.* at 8.

GCA maintains that “an incentive soundly based on productivity improvement could be worthwhile” and agrees with UPS that the Postal Service should develop

¹⁹⁹ Comments of the American Catalog Mailers Association, Inc. (ACMA) and the Parcel Shippers Association (PSA), March 1, 2018, at 23 (ACMA/PSA Comments).

parallel TFP measures for the Market Dominant and Competitive products business. GCA Reply Comments at 19-21. GCA claims that the achievement of Objective 1 would be “subverted if the additional rate authority for market-dominant products is generated by efficiency gains which do not benefit them” and instead benefit Competitive products. GCA Reply Comments at 19. PSA disagrees.²⁰⁰ Specifically, PSA disagrees with UPS that “developing separate TFP figures for market dominant products and competitive products would be a simple matter” and concludes that it “would be impossible to do in a non-arbitrary way.” PSA Reply Comments at 8-9. PSA contends that, similar to institutional costs, “a large share of the Postal Service's labor, capital, and material inputs serve both competitive and market dominant products jointly or in common and cannot be causally attributed to either.” *Id.* at 8.

In its reply comments, the Postal Service disputes “UPS’s claim that developing separate TFP measures for market-dominant and competitive products would be a ‘simple matter[.]’” Postal Service Reply Comments at 86 n.231. The Postal Service explains that:

Setting aside the technical complexities of using [Cost and Revenue Analysis] cost component definitions to split TFP resource usage, TFP is fundamentally an enterprise-wide productivity measure that includes institutional costs in its measure of resource usage, and organization-wide delivery network growth in addition to mail and service volumes in its measure of postal output. As the Commission is well aware, there is no causal basis for allocating institutional costs between market-dominant and competitive products. See Order No. 4402 at 81-82. The need to conduct economically arbitrary allocations of institutional costs and network-related output would make the resulting disaggregated productivity measures unreliable. As an additional practical matter, no such breakout of historical TFP data is available for use in determining a reasonably achievable benchmark or other aspects of a performance incentive mechanism.

Postal Service Reply Comments at 86 n.231.

²⁰⁰ Reply Comments of Parcel Shippers Association (PSA), March 30, 2018, at 8-9 (PSA Reply Comments).

Comments on application and measurement of TFP. In Order No. 4258, the Commission proposed to evaluate in the ACD “whether average TFP growth for the most recent 5-year period has met or exceeded 0.606 percent.” Order No. 4258 at 62. Comments were received regarding whether the proposed benchmark level of 0.606 percent would be achievable by the Postal Service; whether the proposed standard of 0.606 percent is representative of the average growth for TFP; and whether the proposed standard will actually incentivize efficiency gains.

The Postal Service claims that the “proposed benchmark level [of 0.6 percent] would also be all but impossible to achieve[,]” as the benchmark is higher than the average annual efficiency gains under the current system over the full 10-year period. Postal Service Comments at 98-99, 102-108. The Postal Service notes that under a rolling average, below-threshold years necessarily raise the threshold in future years, creating an even more unachievable benchmark. *Id.* at 117-118. APWU concludes that the “0.6 percent TFP benchmark the Commission has identified is, based on the evidence before the Commission, plainly unachievable” and that the Commission “points to nothing that suggests the Postal Service can meet the [proposed benchmark].” APWU Comments at 16-17. Netflix claims that the proposed use of a 5-year average for TFP renders the measure “particularly impractical” as “it is unlikely that the 0.75% Efficiency Mechanism will be attainable in the first two to three years of the Commission’s proposed plan.” Netflix Comments at 22.

In contrast, other commenters allege that the benchmark level of 0.6 percent is easily achievable by the Postal Service. NPPC *et al.* contend that “relying on recent TFP sets the bar too low to present a meaningful challenge” based on the fact that TFP has been low in recent years. NPPC *et al.* Comments at 9. UPS also questions the Commission’s proposal to use a 5-year rolling average for a TFP benchmark and “urges the Commission to set a higher benchmark for productivity growth to incentivize the Postal Service to do better than it has in the recent past.” UPS Comments at 8. DMA

submits that the 0.75 percentage point performance-based rate authority rewards the Postal Service for “maintaining its current productivity record.” DMA Comments at 4. NMA also states that the efficiency component of the performance-based rate authority, “while at least aiming at improving efficiency, is accompanied with such a modest threshold that it amounts to simply giving the Postal Service that much more money.” NMA Comments at 10.

With respect to the proposed standard of 0.606 percent as representative of the average growth for TFP over the 5-year period from FY 2011 to FY 2016, numerous commenters dispute the use of this period as the benchmark. The Postal Service suggests using a benchmark period between FY 2014 and FY 2018, claiming that the Commission’s proposed period is not representative, as it fails to account for the most recent years and is not particularly meaningful on its own. Postal Service Comments at 96-98, 114, 128. The Postal Service also disagrees with the premise used by the Commission to support the use of a rolling average, especially the idea that the rolling 5-year average will allow time for the effects of long-term investments to appear in the TFP calculation and that it would minimize the effect of an unrepresentative annual result. *Id.* at 109-112. To remedy this perceived deficiency, the Postal Service proposes establishing a “deadband” or “neutral zone” to account for certain factors outside of its control and uncertainty consistent with regulatory practice. *Id.* at 100-102, 122-123.

The Public Representative raises concerns that the 5-year average time period is too short and that “growth should be measured during a longer period, such as 7-8 years.”²⁰¹ ACMA and PSA suggest that a 5-year rolling average may be “too short to be meaningful” and that the Postal Service will be unable to meet the threshold of 0.6 percent based on the previous 5-year period. ACMA/PSA Comments at 22-23.

²⁰¹ PR Comments at 34 (quoting Bzhilyanskaya Supplemental Declaration at 8).

NPPC *et al.* claim that the years used for the proposed 0.6-percent benchmark, FY 2011 to FY 2016, reflect “a period in which the Postal Service experienced poor operational productivity and its cost reductions and efficiency gains were less than under prior law.” NPPC *et al.* Comments at 67. They suggest that this time period should not be used as the “hurdle to be achieved” and should be strengthened to “encourage proper behavior.” *Id.* Accordingly, NPPC *et al.* propose the benchmark 0.6-percent average target be modified to a TFP threshold of approximately 1.25 percent, which reflects the number closest to “what was achieved under the prior law when operational efficiency was improving[.]” *Id.* at 67-68.

The Postal Service responds to comments proposing a longer period of TFP benchmarking, stating that it would only exacerbate methodological problems created by the proposed “comparison between two sets of accumulating averages.” Postal Service Reply Comments at 83. Further, the Postal Service contends that extending the benchmark period and the measured period would only serve to “place the TFP-based rate authority further out of reach[.]” *Id.* at 84.

In addition to comments on the level of the benchmark, NPPC *et al.* suggest two additional modifications to the proposal. First, NPPC *et al.* suggest that the Commission require that “TFP must not only exceed a benchmark that would represent actual improved performance, but must also be positive.” NPPC *et al.* Comments at 68. Second, they contend that the proposed performance-based rate authority be modified to include a reduction in rate authority for each year that the benchmark for performance is not met. *Id.* at 69. Similarly, ANM *et al.* contend that the performance-based rate authority should not provide “*additional* pricing authority to reward improvements in productivity,” and that rate authority is generally reduced “to force the regulated monopoly to *share* some of its realized productivity gains with its captive customers.” ANM *et al.* Comments at 53 (emphasis in original).

ANM *et al.* claim that the proposed performance-based rate authority fails to “maximize incentives” to increase productivity “because it provides no incentive for the Postal Service to increase productivity any faster than under the current system of ratemaking.” *Id.* at 54. The Public Representative also contends that this authority would be granted “for simply maintaining the efficiency gains averaged over the previous 5 years, not for increasing the annual average of the most recent 5 years of efficiency gains.” PR Comments at 33. As this conflicts with the Commission’s finding that the incentives to increase operational efficiency were not maximized throughout the PAEA era, the Public Representative suggests that the “operational efficiency-based standard should be higher than the average TFP growth in the most recent 5 years.”²⁰² NPPC *et al.* also express their concern that, under the proposed performance-based rate authority, “the Postal Service would receive the entire benefit upon hitting the TFP target[]” so that a “1.607 percent TFP gain would earn it no more extra rate authority than a 0.607 percent gain.” NPPC *et al.* Comments at 68.

Finally, the Postal Service seeks clarification on the rounding of decimal places that would be used to measure the benchmark and urges rounding to a single decimal place, as is consistent with the Bureau of Labor Statistics’ practice. Postal Service Comments at 96, 113, 122, 125.

²⁰² *Id.* at 33-34 (citing Bzhilyanskaya Supplemental Declaration at 7).

Commission analysis. With respect to commenters concerned about the use of TFP as the appropriate benchmark for the operational efficiency component of the performance-based rate authority, the Commission first refers commenters to its analysis of TFP provided in both Order No. 4257 (responding to commenter concerns regarding TFP and finding that TFP was the appropriate measure of efficiency)²⁰³ and Order No. 4258 (responding to commenter concerns regarding TFP).²⁰⁴ In addition to this analysis, as part of its determination to use TFP as a measure of efficiency under this proposal, the Commission engaged the contracting services of Northwest Postal Consulting (NWPC) to conduct a thorough examination of the Postal Service's TFP model and productivity measurements. NWPC issued two reports: the first report provided a review of how accurately TFP measures productivity, and the second report assessed the Postal Service's efficiency for the periods before PAEA and after PAEA.²⁰⁵

In Report 1, NWPC validated the TFP model and methodology and provided an explanation and documentation of the model. NWPC found that the TFP methodology "is relevant and valid" and that "[t]he model results could be used to analyze the impact

²⁰³ See Order No. 4257 at 203-211. "The Commission uses TFP as its determinative metric for operational efficiency because it is the best available measure of efficiency. TFP contains all of the components needed to determine the efficiency of a multi-product firm, and it comprehensively accounts for both the inputs and outputs of the Postal Service. For example, when the Postal Service processes more mail (workload) using the same amount of inputs (labor, capital, and materials), TFP increases, reflecting that the Postal Service has increased its efficiency. Conversely, when the Postal Service uses more inputs for the same amount of workload, TFP decreases, reflecting a decline in [the] Postal Service's efficiency. Because TFP comprehensively measures both inputs and workload, the efficiency changes that occur in a given year are reflected in TFP." *Id.* at 206.

²⁰⁴ See Order No. 4258 at 57-64. "Consistent with Order No. 4257, the Commission uses total factor productivity (TFP) as its determinative metric for operational efficiency because it is the best available measure of efficiency." *Id.* at 57 (citing Order No. 4257 at 206).

²⁰⁵ Northwest Postal Consulting for the Postal Regulatory Commission, Report 1, Adequacy of the Postal Service's TFP Model, March 27, 2017 (Report 1); Northwest Postal Consulting for the Postal Regulatory Commission, Report 2, Comparison of Postal Service Productivity Measurement: Before and After PAEA Enactment, March 27, 2017.

of strategic programs, management initiatives, and operational processes on productivity performance.” Report 1 at 2. As detailed in Order Nos. 4257 and 4258, the Commission uses TFP as the “determinative metric for operational efficiency because it is the best available measure of efficiency.”²⁰⁶ NWPC also concludes that the TFP model “is comprehensive in that it accounts for all of the inputs in the form of the audited accounting costs of the Postal Service” and “[a]ll of the meaningful outputs[.]” Report 1 at 69. As a result, NWPC finds that TFP “provides a complete picture of postal productivity in that it comprehensively accounts for all of the inputs and outputs of the Postal Service.” *Id.*

The Commission notes commenter concern regarding the overall effect of increased capital investments on TFP and contentions that an influx in capital spending could adversely affect TFP. However, it is unlikely that increased capital investments and spending will have a significant effect on overall TFP. As explained by NWPC, capital is an input to TFP that “plays a smaller role in TFP due to the relative small percentage of value compared to Labor and Materials.” *Id.* at 45. In addition, this rulemaking is intended to provide a balance among the objectives set out in section 3622 of title 39, which include the interest in reasonable rates and the interest in achieving financial stability in addition to maximizing incentives to increase efficiency and maintain high quality service standards. As part of this balance, the Postal Service will have an obligation to continue to improve efficiency year-over-year and will have to make prudent decisions to achieve those results. The Postal Service may not meet those targets every year due to a variety of factors. Accordingly, as explained above, the Commission concludes that the potential for increased capital investments to negatively impact TFP is not a sufficient basis to modify the use of TFP as the measure of efficiency.

²⁰⁶ Order No. 4258 at 57 (citing Order No. 4257 at 206).

UPS is incorrect in its position that creating parallel Market Dominant and Competitive TFP measures would be a simple task, as its position represents a misunderstanding of institutional costs and how TFP functions. TFP functions as a measure of the Postal Service's productivity for its entire enterprise and includes institutional costs. As indicated in the Postal Service's and other commenters' responses to UPS's suggestion, institutional costs are not allocated between Market Dominant and Competitive products. Specifically, "[i]nstitutional costs are residual costs that cannot be specifically attributed to products through reliably identified causal relationships."²⁰⁷ Accordingly, the Commission declines to adopt the suggestion to develop separate TFP measures for Market Dominant versus Competitive products.

In response to comments regarding the use of the 5-year average as a benchmark to measure TFP growth, the Commission notes that commenters present opposing views on whether the benchmark is set too high or too low. After considering the comments regarding the benchmark and whether the years chosen would be representative of future efficiency gains, the Commission modifies the proposed benchmark for performance-based rate authority. The Commission removes the 5-year rolling average based on the benchmark average of TFP for FY 2011 and FY 2016. Instead, the Commission will use annual TFP growth as the benchmark for the operational efficiency component of the performance-based rate authority. The Postal Service will meet the operational efficiency-based benchmark if the TFP in a given year exceeds the TFP from the prior year. This shift, from a 5-year average benchmark approach to a year-to-year average approach, allows the Commission to review the Postal Service's operational performance as it changes annually and is not directly influenced by TFP numbers that are more than 5 years old. By comparing the TFP

²⁰⁷ Docket No. RM2017-1, Order Adopting Final Rules Relating to the Institutional Cost Contribution Requirement for Competitive Products, January 3, 2019, at 2 (Order No. 4963).

results from 1 year to the next, the Commission applies a more straightforward approach that allows for a transparent review of the Postal Service's efficiency gains.

The Commission recognizes that TFP may not immediately show the impact of short-term operational decisions. However, the Commission finds the robustness of the TFP model outweighs this imperfection as it is currently the best measure of the Postal Service's efficiency. Order No. 4257 at 205. By reviewing TFP on a yearly basis, the Commission expects the Postal Service to show efficiency gains every year despite these limitations. The Commission also acknowledges that, however unlikely, it is possible that the Postal Service could engage in efforts to influence TFP results by not making the best business decisions. As previously explained, the additional performance-based rate authority provides a mechanism for additional revenue to allow the Postal Service to make capital investments, regain its borrowing authority, and reenter the financial health cycle. It is up to the Postal Service to use this mechanism, with any alleged imperfections, as a tool to meet the objectives of the PAEA.

With respect to the alignment of the proposed performance-based rate authority with the Commission's findings on Objective 1, some commenters contend that the proposed metrics will not ensure that the incentives to reduce costs and increase efficiency are maximized in accordance with the analysis in Order No. 4257. In response, the Commission notes that the proposed modifications of the system do not fit neatly into satisfying each objective under the PAEA. Rather, as the Commission indicated in Order No. 4258, this specific part of the modified system, the performance-based rate authority, presents a response to the problem created by the failure to achieve Objectives 1, 3, and 5 and the resulting effects on the financial health cycle of the Postal Service. See Order No. 4258 at 46-47. The performance-based rate authority will act to supplement the function of the price cap as an incentive to increase efficiency within the proposed ratemaking system. As previously explained, "[c]onditioning rate authority on increases in TFP incentivizes the Postal Service to

maximize output while minimizing costs, leading to improvements in operational efficiency.” *Id.* at 61.

The Commission declines to implement a penalty component to the performance-based rate authority, as it conflicts with the finding that the Postal Service requires additional funds for capital investments in order to reestablish the financial health cycle and enable the Postal Service to achieve Objectives 1, 3, and 5. As previously explained, the Commission intends to monitor the performance-based rate authority and review its performance over the next 5 years. After the 5-year period, the Commission will consider whether the modified system of Market Dominant ratemaking and classification implemented through this rulemaking has succeeded in achieving the objectives of the system. The Commission will explore at that time the utility of adjusting the performance-based rate authority.

With respect to the Postal Service’s comments seeking clarification on the amount of decimal places, the Commission will assess the change in TFP from year-to-year to three decimal places. In response to NPPC *et al.*’s concern regarding the potential for TFP to be negative but still receive performance-based rate authority, the Commission also clarifies that the yearly change in TFP necessary to satisfy the benchmark for operational efficiency must be positive.

4. Service Standards as Benchmark

The Commission also received numerous comments on the proposal to base 0.25 percentage points of the 1 percentage point of additional performance-based rate authority on the maintenance of service standards.²⁰⁸

Comments. Commenters generally disagreed with conditioning additional rate authority on the maintenance of service standards for a variety of reasons. The Postal Service generally opposes tying service standards to pricing authority but submits that the magnitude of the authority was small enough that it would not deter management from making service standard changes. Postal Service Comments at 130-131. The Postal Service disagrees with the Commission's finding that Objective 3 was not achieved and claims that any such failure is linked to the "lack of capital to invest in maintaining and improving service quality." *Id.* at 27, 31-32. As a result, the Postal Service "questions the Commission's conclusion that any remedy is necessary concerning service standards[.]" *Id.* at 130.

Other commenters objected to the proposal's focus on service *standards*, as opposed to service *performance*. ACMA and PSA claim that the service incentive of 0.25 percentage points is not likely to be effective, as it is based on a change to the published service standard, unrelated to performance. ACMA/PSA Comments at 19. ANM *et al.* also contend that the 0.25 percentage points for the service component

²⁰⁸ There are two distinct aspects to service. The first of these, service standards, constitutes the stated days-to-delivery for different types of mail. The second, referred to as service performance, is the measurement of how often the Postal Service meets its stated service standards. See Order No. 4257 at 250. In Order No. 4257, the Commission analyzed whether high quality service standards have been maintained during the PAEA era. *Id.* at 273 (citing 39 U.S.C. § 3622(b)(3)). The Commission determined that service standards declined during the PAEA era, because the Postal Service reduced the high quality service standards that were set in 2007. Order No. 4257 at 273. The Commission concluded that the goals of the PAEA with regard to Objective 3 were not achieved because the regulatory system did not effectively encourage the Postal Service to maintain service standards quality. *Id.* The Commission includes a service standard benchmark in its proposal to encourage the Postal Service to maintain service standards quality.

proposed by the performance-based rate authority is arbitrary where it “is tied not to actual service performance, but to the published standards, which the Postal Service may or may not achieve.” ANM *et al.* Comments at 83. NPPC *et al.* take issue with the service standard aspect of the 0.25 percentage point performance-based rate authority, stating that it “does not ensure high quality service and rewards the Postal Service for literally doing nothing.” NPPC *et al.* Comments at 76. NPPC *et al.* contend that “[a]lthough the amount of money at stake here...is relatively small in the overall context of the Postal Service, the point is that if the rate regulatory system is to be used as an incentive for service quality,” it should be designed to reward the Postal Service only for exceeding standards. *Id.* at 79. Netflix also criticizes the service component of the performance-based rate authority for measuring service standards, not actual performance, meaning that the Postal Service can receive the 0.25 percentage points of additional rate authority by doing nothing. Netflix Comments at 23. UPS suggests that the “‘service quality-based rate authority’ should be contingent on the actual service quality achieved by the Postal Service.” UPS Comments at 9. UPS recommends that the Commission review the service performance and service standards in its ACD proceeding and qualify any additional rate authority on the outcome of that review. *Id.* at 9-10.

Unlike the majority of commenters on this issue who seek to have the Commission regulate service performance, the Postal Service replies that “[t]he [p]lain [l]anguage of Objective 3 [d]emands a [f]ocus on [s]ervice [s]tandards, [r]ather [t]han [p]erformance.” Postal Service Reply Comments at 86. Further, the Postal Service claims that “the experience of other postal regulators disfavors tying rate authority to service performance” and that the “variability of service performance, for reasons beyond the Postal Service’s control,” would “isolate the incentive effect of a price cap factor.” *Id.* at 88-89. The Postal Service also cautions the Commission against conditioning a “more substantial amount of rate authority on maintaining (potentially inefficient or otherwise undesirable) service standards.” *Id.* at 87-88.

Commenters also disagree with the service standards benchmark as an incentive. ACMA and PSA contend that the proposal is one-sided, where there is no incentive to increase service standards. ACMA/PSA Comments at 20. Netflix submits that the service component of the performance-based rate authority is contrary to service quality regulation in other industries, where a “regulator may decrease the cap if service levels slip.” Netflix Comments at 23-24. Netflix states that providing additional rate authority to the Postal Service for “not changing service standards may be counter-productive to effective operations” because “[c]hanges in standards, based on costs, needs, and changed circumstances, should be an ordinary part of operating a postal system.” *Id.* at 24. Netflix expresses concern that the service component of the additional performance-based rate authority may result in the Postal Service failing to change certain cost-saving or efficiency service standards “if it results in [a] loss of cap authority.” *Id.* ACMA and PSA allege that an incentive to maintain service standards could preclude the Postal Service from making changes to its operations in response to “volume declines and pressures to meet a budget despite these declines.” ACMA/PSA Comments at 19-20. MH and NAAD state that the objective of high quality service standards must “be balanced realistically against the associated costs and the availability of revenue needed to meet that objective.” MH/NAAD Comments at 5.

Similarly, UPS states that proposed service standard performance-based rate authority does not incentivize actual service quality. UPS Comments at 9. Its concern is that “[s]o long as the Postal Service has not lowered its *stated* service standards, the Postal Service will be granted 0.25% additional rate authority, whether or not the Postal Service is actually performing in line with those standards.” *Id.* (emphasis in original). The Public Representative contends that the “service quality based rate authority of 0.25 percent” is not supported by any analysis to “demonstrate that the 0.25 percent annual rate authority offers sufficient incentive to maintain Service Standards (and business rules).” PR Comments at 36. The Public Representative also claims that the “relatively small amount of potential revenue” from the 0.25 percentage points of

additional rate authority would not act as an incentive to maintain service standards. *Id.* at 36-37. DMA claims that the proposal creates an “anti-customer incentive” because customers pay the Postal Service “to deliver mail within the service standards,” but the proposal would reward the Postal Service “for doing the task for which it has been paid by the customer by increasing the price paid by the customer.” DMA Comments at 3.

Commenters also dispute the efficacy of the Commission’s ACD review of service performance. With respect to the Commission’s plan to continue monitoring service performance in its ACD, ANM *et al.* claim that mechanism has resulted in “declining and degraded” service performance. ANM *et al.* Comments at 84. NPPC *et al.* state that the Commission’s plan to monitor actual service quality through ACD proceedings “has been ineffective in forcing the Postal Service to meet even the reduced service standards.” NPPC *et al.* Comments at 78. Additionally, DMA submits that the Postal Service “fails to adequately measure service performance for at least 20 percent of mail” and that “[t]here should be no service reward without complete measurement.” DMA Comments at 5. The Postal Service concludes that the “Commission correctly commits service performance issues to the annual compliance review.” Postal Service Comments at 131.

NPPC *et al.* suggest modifying the proposal to prohibit the Postal Service “from reducing service at any time between the end of a Fiscal Year in which such extra authority is earned until after it is implemented” in order to solve the timing issue and “prevent mailers from paying higher rates while service worsens.” NPPC *et al.* Comments at 80. Similarly, MH and NAAD recommend that the proposal be modified so that the associated rate increase is available only once, and that it “should be susceptible to reversal should ‘service performance’ regress thereafter[.]” MH/NAAD Comments at 8. DMA also proposes that the Commission ensure that any reduction in the service standards causes the additional rate authority to “vanish forever.” DMA Comments at 5.

Commission analysis. In response to comments that contend the proposal should regulate service performance versus service standards, the proposed rule adds a mechanism to regulate changes in service standards in addition to the existing regulation of service performance in the ACD. As stated by the Commission in Order No. 4257, “a system meeting Objective 3 is one which encourages the maintenance of high quality service standards established pursuant to 39 U.S.C. § 3691, and in which the Postal Service is held accountable for consistently achieving those standards.” Order No. 4257 at 250. In order to ensure maintenance of high quality service standards, the proposed performance-based rate authority contains a component that provides additional rate authority only if the Postal Service maintains its high quality service standards. For the second piece, the accountability for achieving those standards, the Commission determined that the existing review of service performance in the ACD provides a basis for accountability.²⁰⁹

As part of its determination on how to design a ratemaking system that addresses deficiencies found in the current system with respect to Objective 3, the Commission engaged the services of Copenhagen Economics to conduct a thorough examination of whether quality of service could be included as a modification to the system of ratemaking and what considerations should be taken into account during any implementation process. See Copenhagen Economics Report. In general, Copenhagen Economics found that changing postal market conditions call for a cautious regulatory approach. Implementation of factors designed to regulate service quality would need to strike a balance between real concerns regarding the quality

²⁰⁹ *Id.* at 273. In response to the commenter who contends that the service performance measurement system is incomplete, this issue was addressed in separate proceedings. See Docket No. PI2018-2, Order Conditionally Approving Modifications to Market Dominant Service Performance Measurement Systems, November 5, 2018 (Order No. 4872); Docket No. PI2018-2, Order Closing Docket, December 27, 2018, at 2 (Order No. 4945); Docket No. PI2019-1, Order Conditionally Authorizing the Postal Service to Proceed with Changes to its Market Dominant Service Performance Measurement Systems, July 17, 2019 (Order No. 5157).

levels provided by the postal operator and the administrative and regulatory burden of such a system. As the report described, to achieve an optimal outcome, changes in the price cap triggered by changes in service performance should mirror postal service users' willingness to pay for higher quality.

With respect to comments that dispute that the service component is an incentive, the service component is intended to provide an additional incentive to maintain high quality service standards where the system under the PAEA has no such mechanism. As previously recognized, within a price cap system, there is "the potential to cut costs by way of service reductions to comply with price cap requirements."²¹⁰ The Commission noted that there were several reductions in service standards over the 10-year period from FY 2006 to FY 2017. Order No. 4257 at 266-269. In light of the extreme financial stress of the Postal Service and its inability to reenter a healthy financial cycle in the absence of additional revenue, the Commission imposes the condition that the Postal Service must maintain its high quality service standards in order to be eligible for the additional performance-based rate authority. This condition not only acts as a control on the Postal Service's ability to attain additional needed revenue, but it also acts as an incentive to encourage decision-making that includes in its consideration the maintenance of high quality service standards. As previously explained, this rule is proposed to "strike a balance between relieving the financial pressure to allow the Postal Service the opportunity to improve service and incentivizing the Postal Service to maintain high quality service standards for its market dominant products." Order No. 4258 at 72.

The Commission declines to modify the proposal in response to commenters who suggest the additional rate authority should disappear in future years if the Postal

²¹⁰ Order No. 4257 at 255 (quoting Postal Regulatory Commission, Section 701 Report, Analysis of the Postal Accountability and Enhancement Act of 2006, September 22, 2011, at 2 (internal marks omitted)).

Service decides to reduce service standards in 1 year. As pointed out by other commenters, the Postal Service may have justified reasons for reducing its high quality service standards and the statute under the PAEA does not prevent it from doing so. As a result, the Commission's proposal seeks to provide an incentive to maintain high quality service standards while not prohibiting necessary modifications to future service standards.

The Commission agrees with commenters who contend that the amount of the rate authority for the service component of the rule may be insufficient to act as an incentive to maintain high quality service standards. In addition, the Commission agrees that increasing the percentage of performance-based rate authority that may be attained for maintaining high quality service standards will act to strengthen the incentive. Accordingly, the Commission removes the 0.25 percentage point designation for service standards and the 0.75 percentage point designation for operational efficiency. Instead, and as described in further detail below, the Commission modifies the rule to require that both the service component and the operational efficiency component be met prior to receiving the additional 1 percentage point of performance-based rate authority.

5. Split Between Operational Efficiency and Service Standards

Commenters provide input on the proposal to split the 1 percentage point of performance-based rate authority between operational efficiency at 0.75 percentage points and service standards at 0.25 percentage points.

Comments. Commenters generally disagree with the proposal to split the 1 percentage point of rate authority between operational efficiency and service standards. Certain commenters claim that the choice of 0.75 and 0.25 for the split is not justified. Specifically, ANM *et al.* contend that the 0.75 percent split for operational efficiency lacks "reasoned explanation" because the "Commission offers no data or analysis to

show that a surcharge of 0.75 percent is either necessary or sufficient to incent optimal rates of productivity growth.” ANM *et al.* Comments at 56. The Public Representative also contends that there is no justification for the “selection of 0.75 percent for increased rate authority.” PR Comments at 33. NALC states that the proposed splits of 0.75 and 0.25 would “create an incentive for postal management to sacrifice service for the sake of efficiency gains, in contravention of the statute.” NALC Comments at 4, 17-18.

As a modification, UPS proposes that any rate authority above the CPI be contingent on a split of 50/50 efficiency and service, with half of the authority “contingent on achievement of objective one...and half...contingent on achievement of objective three[.]” UPS Comments at 5. NPMHU submits that service performance is at least as important as operational efficiency, and also suggests an equal weighting of 0.5/0.5 for the performance-based rate authority versus the proposed 0.75/0.25 split. NPMHU Comments at 6.

The Public Representative suggests that the Commission modify the proposal and tie “the two incentives together by requiring *both measures to be met* before qualifying for the 1 percent rate allowance[.]” PR Comments at 37 (emphasis in original).

Commission analysis. In response to the comments regarding the split of the percentage point of rate authority between operational efficiency and service standards, the Commission agrees with commenters that the two components should be considered equally. Accordingly, the Commission modifies the proposed rule to remove the split of 0.75 percentage points for operational efficiency and 0.25 percentage points for service standards. The Commission adopts the Public Representative’s suggestion and modifies the proposed performance-based rate authority so that both conditions, the operational efficiency and the service standard conditions, must be met in order to receive the 1 percentage point of performance-based rate authority.

Not only will this remedy the unequal weighting between operational efficiency increases and the maintenance of service standards under the performance-based rate authority, but it will also strengthen the incentive for the Postal Service to achieve both Objectives 1 and 3. With the proposed modification, failure to meet either benchmark will result in disallowance of the entire amount of additional performance-based rate authority. By conditioning the 1 percentage point of authority on meeting both the TFP and service standard benchmarks, the proposed performance-based rate authority now provides equal incentive for the Postal Service to focus on increasing its efficiency while maintaining high quality service standards.

6. Effect of Proposals

Comments were submitted regarding the permanent nature of the performance-based rate authority and the effect on mailers and the administrative process.

Comments. Numerous commenters noted their concern about the permanent nature of the rate increase for achievement of the performance-based rate authority and the lack of a sunset provision.²¹¹ Specifically, Netflix notes that an increase in the proposed TFP measure “in one year would result in a permanent rate increase and lead to a stream of additional revenue that would go on forever, even when subsequent TFP measures become stagnant or decline.” Netflix Comments at 23. ACMA and PSA state that a “baked-in” authority incentive obligates mailers to pay higher rates forever based on a decision merely to not reduce current service standards in one individual year. ACMA/PSA Comments at 21. NPPC *et al.* also raise their concern that the proposed performance-based rate authority does not contain a sunset proposal or time that the authority would terminate. NPPC *et al.* Comments at 68. DMA proposes having the

²¹¹ See, e.g., ACMA/PSA Comments at 23; DMA Comments at 4; NPPC *et al.* Comments at 68.

additional rate authority “be a bonus for the year and not included in the rate base.” DMA Comments at 4.

In addition to addressing the permanent nature of the rate increase, NPPC *et al.* propose that the performance-based rate authority be modified to sunset after “five years and be subject to a new Commission review.” NPPC *et al.* Comments at 79. The Postal Service proposes that the Commission allow the performance-based rate authority to be banked, with constraints if necessary, claiming that “[a]llowing the banking of this additional authority would serve the same purposes as the banking of CPI authority.” Postal Service Comments at 132.

Certain commenters note their concern with the proposed performance-based rate authority’s effect on mailers. AF&PA expresses its disagreement with the proposal in general, concluding that mailers should not pay a penalty for the Postal Service’s cost control efforts. AF&PA Comments at 7. ACMA and PSA also view the rate increase for performance-based rate authority as a penalty to mailers and claim that mailers should not be penalized by paying higher rates in response to the Postal Service achieving success in managing its operations. ACMA/PSA Comments at 21-23. NPPC *et al.* raise their concern that the Postal Service may be implicitly asking Market Dominant mailers to finance Competitive product investments; however, they note that the “accrued costs of these investments, if made, might be attributed to Competitive products.” NPPC *et al.* Reply Comments at 36.

With respect to the administrative process, NALC submits that the additional performance-based rate authority mechanism would “[i]ncrease the [a]dministrative [b]urden of the [r]atemaking [p]rocess and [i]ncentivize USPS to [r]educe [s]ervice [s]tandards.” NALC Comments at 17. NALC submits that the proposal would “lead to frequent, complicated and unpredictable rate proceedings before the Commission over whether USPS achieved the efficiency targets in a given year.” *Id.* at 3. NALC contends that “[d]isputes between stakeholders over how TFP should be calculated and

what data should be used for such a calculation would almost inevitably generate contentious and drawn-out hearings.” *Id.* at 17.

Commission analysis. With respect to commenters who contend that the rate increase should not be included in the rate base, the alternative would require the creation of a rate surcharge mechanism. The Commission has considered the utility of a surcharge and declines to modify the proposal at this time. The proposed performance-based rate authority represents a modification to the system of ratemaking under the PAEA and is specifically designed to bolster long-term financial stability by creating permanent incentives to increase operational efficiency and maintain high quality service performance, as opposed to a temporary surcharge. The Commission in Order Nos. 4257 and 4258 discussed how the system under the PAEA failed to achieve various objectives, the failure of which places the Postal Service in a dire financial condition that will continue to degrade unless modifications are made to give the Postal Service the tools to meet the objectives of the PAEA. Therefore, a modification to the system itself is necessary in this situation.

Although the Commission will monitor the progress of the performance-based rate authority and review the effect of the incentive over the 5-year period before the next review, the Commission declines to modify the proposal to include an automatic sunset provision at the end of the 5-year period. As stated above, this performance-based rate authority is intended to incentivize the Postal Service to increase its efficiency and maintain high quality service standards so that it can reenter the financial health cycle and achieve the objectives of the PAEA. The incentive mechanisms are intended to operate as a permanent part of this new system and are not subject to sunset.

The Commission is mindful of commenter concerns that providing the Postal Service with additional performance-based rate authority could act as a penalty for mailers. However, as determined by Order No. 4257 and explained in Order No. 4258,

the Postal Service is suffering from a break-down of the financial health cycle that requires significant modifications to the system of ratemaking in order to move towards recovery. Specifically, the approach proposed by the performance-based rate authority balances the need to assure the Postal Service's long-term financial stability by addressing three interrelated deficiencies of the existing ratemaking system. Order No. 4257 at 46. By not solely focusing this approach on Objective 5 but also requiring the Postal Service to focus on achieving Objectives 1 and 3, the approach conditions any additional rate authority on the achievement of specific performance-based benchmarks that are intended to improve the entire Market Dominant system. Although mailers may have divergent views on what constitutes a benefit to them, this proposal is intended to balance the needs of the Postal Service to continue its operations with the fact that the mailers provide the financing for those operations. The Commission also finds that the proposed performance-based rate authority may have a positive effect on Objective 7. By providing additional funds for capital investments, the Postal Service may be able to use a portion of those funds to enhance mail security and deter terrorism and drug trafficking.

With respect to the commenters' concern that the Postal Service may fund investments for Competitive products initially through Market Dominant revenues, the Commission notes that the cost of such investments must appropriately be allocated to Competitive products and 39 U.S.C. § 3633(a)(2) and 39 C.F.R. § 3015.7(b) require that Competitive products cover such costs.

D. Commission Proposal

As noted above, in this Revised NPR, the Commission is proposing modifications to the performance-based rate authority proposed rules. As discussed in more detail below, the proposed modifications are made in response to comments received in response to Order No. 4258. In addition, the proposed modifications better reflect the Commission's continued determination that the inability to finance capital investments

was an additional driver of net losses during the PAEA era, contributing to the system's inability to meet Objectives 1, 3, and 5.

As a preliminary matter, the revised rulemaking moves the proposed rules for the performance-based rate authority set forth in Subpart E to Subpart F. Accordingly, proposed § 3010.180 is now proposed § 3010.200; proposed § 3010.181 is now proposed § 3010.201; and proposed § 3010.182 is now proposed § 3010.202.

As set forth in proposed § 3010.200, the Commission is instituting a performance-based rate authority in the amount of 1 percentage point per annum for each class of mail. The availability of this performance-based rate authority is conditioned on achieving the benchmark performance measure for efficiency gains and adhering to the service standard-based requirement. Revised proposed § 3010.200 contains both substantive and minor procedural modifications to the timing of the allocation and use of the rate authority.

The Commission modifies proposed § 3010.200 with respect to the conditions necessary to receive the performance-based rate authority by removing the weighting attached to the operational efficiency-based requirement and the service performance benchmark. The 1 percentage point of rate authority will be allocated based on meeting both the operational efficiency-based requirement set forth in proposed § 3010.201 and the service standard-based requirement set forth in proposed § 3010.202. The revised proposed rule removes the reference to the 0.75 and 0.25 allocation of percentage points.

Revised proposed § 3010.200(b) makes additional procedural changes that include a requirement that the Postal Service file notice with the Commission each year that demonstrates whether or not performance-based rate authority is eligible to be authorized. Section 3010.200(c) provides that the Commission will review the Postal Service's notice and any challenges to the notice under proposed § 3010.202(b). Proposed § 3010.200(c)(3) and (4) retains the language that the rate authority

generated under the performance-based rate authority will lapse if unused, 12 months after the Commission's announcement, and shall not be used to generate unused rate authority or affect existing bank authority.

Proposed § 3010.201 retains TFP as the determinative metric and removes the requirement that the Postal Service's TFP averaged over 5 years must meet or exceed 0.6 percent and instead requires that the Postal Service's TFP for the measured fiscal year must exceed the previous fiscal year in order to meet the operational efficiency-based requirement. Proposed § 3010.201 is also revised to remove the reference to the Commission's ACD and is replaced by the language, "as determined by the Commission."

Proposed § 3010.202(a) retains the service standard benchmark which measures whether all of the Postal Service's service standards (including applicable business rules) for a class of mail for the applicable year met or exceeded the service standards in place during the prior fiscal year on a nationwide or substantially nationwide basis. Proposed § 3010.202(a) is revised to include non-substantive language changes and removes the reference to the Commission's ACD. Proposed § 3010.202(b) is revised to modify the procedures for challenges to the determination and clarifies that challenges are to be filed with respect to the notice provided by the Postal Service under proposed § 3010.200(b).

VI. NON-COMPENSATORY PRODUCTS AND CLASSES

The proposed changes presented in this section impose rate design requirements on non-compensatory products and classes. The Commission previously proposed changes for non-compensatory products and classes in Order No. 4258. The current proposal differs from the changes proposed in Order No. 4258 in two ways: (1) the Commission now proposes that the determination of whether a product or class is non-compensatory may be made outside of the ACD proceeding; and (2) the Commission proposes that the additional 2 percentage points of rate authority for non-compensatory classes of mail be optional rather than mandatory.

In Order No. 4258, the Commission proposed additional rate authority for non-compensatory classes and products to increase revenue. See Order No. 4258 at 77, 84-85. In this section, the Commission addresses comments received in response to the proposal, explains the changes to the proposal, and summarizes the proposed regulatory changes for non-compensatory products and classes.

A. Non-Compensatory Products

1. Introduction

Non-compensatory products are those products for which attributable costs exceed revenue. In the FY 2018 ACD, the Commission identified eight non-compensatory products: (1) In-County Periodicals; (2) Outside County Periodicals; (3) USPS Marketing Mail Flats; (4) USPS Marketing Mail Parcels; (5) Stamp Fulfillment Services; (6) Inbound Letter Post; (7) Media Mail/Library Mail, and (8) the Market Dominant negotiated service agreement (NSA) with PHI Acquisitions, Inc. (PHI).²¹²

²¹² Docket No. ACR2018, *Annual Compliance Determination*, April 12, 2019, at 2, 40-96 (FY 2018 ACD). The Commission also found that Inbound Registered Mail (within the International Ancillary Services product) did not cover costs in FY 2018. See FY 2018 ACD at 89. In Order No. 4258, the Commission identified 10 non-compensatory products, based on the FY 2016 ACD. See Order No. 4258 at 74.

Table VI-1 below shows the percentage of total attributable costs recovered by these products respectively (*i.e.*, their “cost coverage”) and their cumulative negative contribution from FY 2008 to FY 2018.

Table VI-1
Non-Compensatory Products: FY 2018 Cost Coverage and
Cumulative Negative Contribution for FY 2008-FY 2018²¹³

Classes: Products	FY 2018 Cost Coverage (%)	Cumulative Negative Contribution FY 2008-FY 2018 (\$ Billions)
Periodicals: In-County	67.1	0.229
Periodicals: Outside County	67.2	6.034
USPS Marketing Mail: Flats	68.7	5.922
USPS Marketing Mail: Parcels	58.5	0.879
Special Services: Stamp Fulfillment Services ²¹⁴	87.4	0.017
First-Class Mail: Inbound Letter Post ²¹⁵	83.8	0.795
Package Services: Media Mail/Library Mail	76.7	0.626
Total		14.671

Source: Docket No. ACR2018, Library Reference PRC-LR-ACR2018-5, April 12, 2019, Excel file “FY 2018 Periodicals Cost Coverage.xlsx;” FY 2018 ACD at 48, 72, 78, 82, 92; Library Reference LR-RM2017-3/1, December 1, 2017, Excel file “PRC-LR-RM2017-3-1.xlsx,” tab “Table II-15;” Docket No. ACR2017, Library Reference PRC-LR-ACR2017-1, March 29, 2018, Excel file “17Summary_LR1.xlsx;” Docket No. ACR2018, Library Reference PRC-LR-ACR2018-1, April 12, 2019, Excel file “18Summary_LR1.xlsx.”

²¹³ The Commission found that the PHI NSA did not meet the criteria of 39 U.S.C. § 3622(c)(10)(A). FY 2018 ACD at 96. The PHI NSA is not included in Table VI-1 because the Postal Service terminated the contract in FY 2018. *See id.*

²¹⁴ The time period for the calculation of the cumulative negative contribution for Stamp Fulfillment Services is FY 2010 to FY 2018. Product-level contribution for this product was first reported in FY 2010.

²¹⁵ The time period for the calculation of the cumulative negative contribution for Inbound Letter Post is FY 2010 to FY 2018. Product-level contribution for this product was first reported in FY 2010.

With the exception of the two Periodicals products—In-County Periodicals and Outside County Periodicals, which will be addressed subsequently in this Order—all of these non-compensatory products are included within classes of mail for which the overall class revenue exceeds overall class attributable cost. Products such as USPS Marketing Mail Flats, Stamp Fulfillment Services,²¹⁶ and Media Mail/Library Mail have historically failed to cover their attributable costs. See *id.* at 49, 78, 92.

In Order No. 4257, the Commission found that non-compensatory products are not reasonably or efficiently priced and threaten the financial integrity of the Postal Service because revenue from these products fails to cover costs. See Order No. 4257 at 139-142, 235.

The Commission proposed modifications to the ratemaking system that will require price increases to improve the cost coverage for non-compensatory products. The Commission proposed to define “non-compensatory products” as products for which attributable cost exceeds revenue, as determined by the most recent ACD. Order No. 4258 at 77. The Commission also proposed to prohibit the reduction of rates for non-compensatory products. *Id.*

Also, for non-compensatory products in classes for which the entire class had revenue that exceeded attributable costs, the Commission proposed to require minimum product-level price increases. *Id.* Under the Commission’s proposal, whenever the Postal Service files a request for the Commission to review a notice of rate adjustment applicable to any class of mail, it will be required to propose to increase the rate for any non-compensatory product within that class by a minimum of 2 percentage points above the percentage increase for the class. *Id.* This proposed rate

²¹⁶ The Stamp Fulfillment Services product provides for the fulfillment of stamp orders placed by mail, phone, fax, or online to the Stamp Fulfillment Services Center in Kansas City, Missouri. See FY 2018 ACD at 78.

increase does not create additional rate authority for the entire class. *Id.* The proposed rate increase must comply with the other rate setting criteria proposed by the Commission in Order No. 4258. *Id.* After addressing any non-compensatory product(s), the Postal Service will retain pricing flexibility with regard to use of the remaining authority under the price cap for that class. *Id.*

The Commission explained that the proposal allows for continued achievement of Objective 4 (allowing the Postal Service pricing flexibility) while making changes necessary to achieve Objective 1 (maximize incentives to increase pricing efficiency) and Objective 8 (establishing and maintaining reasonable rates). *Id.* Moreover, the Commission noted that the price increase would maintain stability and predictability in rates as required by Objective 2. *Id.* at 78. The Commission reasoned that, although the proposal does not mandate immediate full cost coverage for non-compensatory products, the proposal sought to narrow the coverage gap and move non-compensatory products toward full cost coverage over time. *Id.*

2. Comments

The Commission received mixed responses to its proposal. Several commenters oppose the additional authority, citing concern that price increases will create a hardship on mailers and may move mail out of the system.²¹⁷ Some commenters express

²¹⁷ See, e.g., AF&PA Comments at 7; Comments of Time Customer Service Inc. (TCS), March 1, 2018, at 1 (TCS Comments); NMA Comments at 7-8; AMA Comments at 8-9; Comment on 10-Year Rate System Review, RM2017-3, March 2, 2018, at 2 (Bottom Line Comments); Reply Comments of the American Catalog Mailers Association, Inc. (ACMA) and the Parcel Shippers Association (PSA), March 30, 2018, at 9-10 (ACMA/PSA Reply Comments); Comments of the Bradford Group and Hammacher Schlemmer, February 27, 2018, at 2; see also ANM *et al.* Reply Comments at 67-69 (generally opposing the proposal).

concern that the proposal does not consider the Postal Service's failure to contain costs.²¹⁸

The Postal Service comments that forcible reallocation of pricing authority should only be used as a last resort. Postal Service Comments at 142. The Postal Service disagrees with a mandatory "one-size-fits-all" approach to non-compensatory products. *Id.* at 144-145. The Postal Service states that the proposed requirement infringes on its pricing flexibility. Postal Service Reply Comments at 103-105. It suggests there should be a determination of which products to target based on a set criteria, such as the number of years that a product must be persistently non-compensatory with no sign of improvement. Postal Service Comments at 145. The Postal Service also suggests that the "no price reduction" rule should apply at the product level rather than at each price cell, as applying the price reduction rule at the price cell level would unduly constrain pricing flexibility and conflict with compliance issues. *Id.* at 146.

ACMA and PSA oppose the proposal. ACMA/PSA Comments at 25. They state that the proposed rate requirement for non-compensatory products may not provide a significant financial benefit to the Postal Service's finances and therefore is "not a material element in a fix for Postal finances." *Id.* at 6. They also state that the proposal does not allow the Postal Service adequate pricing flexibility as required by Objective 4.²¹⁹ ACMA and PSA further assert that 39 U.S.C. § 3622(c)(2) does not require that each individual product must cover its attributable costs.²²⁰

MH and NAAD recommend that the proposed language be amended to require at least a 2-percent increase annually. MH/NAAD Comments at 9. They also

²¹⁸ See, e.g., DMA Comments at 6; AF&PA Comments at 7; TCS Comments at 2; AMA Comments at 9; ANM *et al.* Comments at 85, 101; ANM *et al.* Reply Comments at 67-69.

²¹⁹ *Id.* at 17-18; see also Reply Comments of Parcel Shippers Association (PSA), March 30, 2018, at 3-4 (PSA Reply Comments).

²²⁰ ACMA/PSA Reply Comments at 3-4; PSA Reply Comments at 2-3.

recommend that specific benchmarks and criteria for "efficiency" be developed for flat-shaped mail, and that the Postal Service not be allowed to exercise its additional rate authority if those benchmarks have not been achieved. *Id.*

The Public Representative submits that by adjusting the price cap above the CPI for exogenous factors, the additional rate authority generated for the compensatory classes will also make additional rate authority available to raise non-compensatory product prices. PR Comments at 59. The Public Representative states that this approach will "foster increases in non-compensatory rates without infringing on the Postal Service's managerial prerogatives." *Id.*

Other commenters support the proposal. See Valpak Comments at 3-5. Valpak comments that using FY 2017 data, the Commission would have to raise the additional authority to 4 percent in order to reach the goal of 91-percent cost coverage in 5 years. *Id.* at 8. Valpak also urges the Commission to adopt a rule that will require the Postal Service to price non-compensatory products to achieve 100-percent cost coverage within a specific timeframe, such as 5 or 6 years. *Id.* In its response to other commenters, Valpak explains that pricing flexibility is simply one of the objectives and all objectives must be balanced against each other.²²¹

3. Commission Analysis

The Commission does not propose any substantive changes to its previous proposal for non-compensatory products. The Commission agrees with the commenters that the Postal Service must work to reduce costs. However, the Postal Service's cost reduction efforts have been unsuccessful.²²² Moreover, the Commission

²²¹ The Valpak Franchise Association, Inc. Reply Comments on the Notice of Proposed Rulemaking for the System for Regulating Rates and Classes for Market Dominant Products, March 30, 2018, at 24, 32-33 (Valpak Reply Comments).

²²² See, e.g., FY 2018 ACD at 66 (discussion of the failure of cost reduction efforts for USPS Marketing Mail Flats).

has limited tools that would directly affect costs and the tools it has used, such as requiring more transparency, requiring additional reporting, and directing the Postal Service to reduce costs, have not eliminated the problem of underwater products. See Order No. 4257 at 235-236. Thus, although the Commission expects the Postal Service to continue to work to reduce costs, the Commission proposes to require minimum product-level price increases to increase revenue.

As previously stated, the Commission recognizes that the proposed solution places some limitation on the Postal Service's pricing flexibility. Order No. 4258 at 77. The Commission finds that Valpak's proposal to adopt a rule that requires the Postal Service to price non-compensatory products to achieve 100-percent cost coverage within a specific timeframe further constrains pricing flexibility. Consistent with the analysis in Order No. 4257, the solution proposed by the Commission allows for continued achievement of Objective 4 (allowing the Postal Service pricing flexibility) while making changes necessary to achieve Objective 1 (maximizing incentives to increase pricing efficiency) and Objective 8 (establishing and maintaining reasonable rates).²²³

The Commission's proposal does not mandate immediate full cost coverage for non-compensatory products, but it does seek to narrow the coverage gap and move non-compensatory products toward full cost coverage over time. Order No. 4258 at 77. The proposal is designed to stop the trend for certain products of declining cost coverage. An additional 2-percentage point rate increase represents an appropriate mechanism for improving cost coverage while simultaneously maintaining stability and predictability in rates, as required by Objective 2.²²⁴ Both the Postal Service and the mailing community will have notice, through the Commission's announcement, of the

²²³ See *id.*; Order No. 4257 at 91-97, 134-142, 230-236; 39 U.S.C. § 3622(b)(1), (4), and (8).

²²⁴ See Order No. 4257 at 65, 103; 39 U.S.C. § 3622(b)(2).

products that are non-compensatory and thus subject to an additional 2-percentage point rate increase.

The purpose of the pricing requirements for non-compensatory products is for the cost coverage of these products to move toward, and eventually above, 100 percent. The Commission previously performed a scenario-based analysis to determine the appropriate level of additional price increases for non-compensatory products. See Order No. 4258 at 78-80. The analysis has been updated with current figures.

In Table VI-2, the most recent CPI-U projections were combined with unit attributable cost growth rates from the most recent 10 years to estimate changes in cost coverage assuming that prices are increased by 1 percent, 2 percent, or 3 percent above the average rate increase for the class.²²⁵ The CPI-U change is projected to be 1.818 percent for the next 5 years. The average increase in the unit attributable cost of USPS Marketing Mail Flats was 4.437 percent per year for the last 10 years. Table VI-1 assumes that the next 5 years will experience the same unit attributable cost change and that CPI-U will conform to projections. Each year, in addition to the CPI-U rate authority, supplemental authority, and performance-based rate authority, either 1 percent, 2 percent, or 3 percent of additional rate authority is applied to estimate the increase in revenue. Table VI-2 details the resulting estimated cost coverages for USPS Marketing Mail Flats.

²²⁵ The unit attributable costs by product are only available for the most recent 10 years due to the product list change associated with the PAEA and concurrent changes to cost reporting. The Postal Service did not report the unit attributable costs for each and every PAEA product until FY 2008. See Docket No. ACR2008, Library Reference USPS-FY08-1, December 29, 2008.

Table VI-2
USPS Marketing Mail Flats Cost Coverage Scenarios

	1.0%		2.0%		3.0%	
Year	Coverage	Increase	Coverage	Increase	Coverage	Increase
Year 0	67.4%	0.0%	67.4%	0.0%	67.4%	0.0%
Year 1	68.4%	5.9%	69.0%	6.9%	69.7%	7.9%
Year 2	69.3%	5.9%	70.6%	6.9%	72.0%	7.9%
Year 3	70.3%	5.9%	72.3%	6.9%	74.3%	7.9%
Year 4	71.3%	5.9%	74.0%	6.9%	76.8%	7.9%
Year 5	72.3%	5.9%	75.7%	6.9%	79.4%	7.9%
Total		29.5%		34.5%		39.5%

In the scenarios detailed in Table VI-2, USPS Marketing Mail Flats would experience 5-year cumulative price increases of between 29.5 and 39.5 percent.²²⁶ Even in the scenario where prices are increased 7.9 percent per year, the estimated cost coverage remains below 100 percent 5 years after implementation. As explained above, Table VI-2 contains the assumption, based on historical data, that unit attributable costs will continue to increase at a higher rate than the CPI-U. The Commission changes this assumption in its calculation in Table VI-3 below.

²²⁶ The 5-year cumulative increases are greater than the sum of the annual increases due to the effects of compounding.

Table VI-3
USPS Marketing Mail Flats Full Cost Coverage Scenario

	1.0%		2.0%		3.0%	
Year	Coverage	Increase	Coverage	Increase	Coverage	Increase
Year 0	69.7%	0.0%	69.7%	0.0%	69.7%	0.0%
Year 1	73.1%	5.9%	73.8%	6.9%	74.5%	7.9%
Year 2	76.6%	5.9%	78.1%	6.9%	79.6%	7.9%
Year 3	80.4%	5.9%	82.7%	6.9%	85.0%	7.9%
Year 4	84.3%	5.9%	87.5%	6.9%	90.8%	7.9%
Year 5	88.3%	5.9%	92.6%	6.9%	97.0%	7.9%
Total		29.5%		34.5%		39.5%

In Table VI-3, unit attributable costs are assumed to increase by 1.0 percent per year, or 3.4 percent below the historical average. If the Postal Service increases prices by 2 percent above the class average and reduces the growth in unit attributable cost by 3.4 percent, the cost coverage still remains below 100 percent after 5 years.

Although Valpak suggests that the Commission increase the prices by 4 percent annually, given the other proposed changes to the system, the Commission must be mindful of the overall effect of additional price increases for non-compensatory products. In the analysis above, an additional 3-percent increase for USPS Marketing Mail Flats would result in a cumulative price increase of more than 39 percent. However, given the continued failure of the Postal Service to reduce costs, cost coverages will continue to decline if revenue is not increased. Using the example above, the Commission finds the 2-percent increase provides additional revenue that, without any cost reductions, would bring cost coverage for USPS Marketing Mail Flats to 75.7 percent after 5 years. With cost reductions, the 2-percent price increase is the minimum amount that would get USPS Marketing Mail Flats to achieve at least 90-percent cost coverage after 5 years.

Thus, the Commission determines that requiring the Postal Service to increase the rate for any non-compensatory product by a minimum of 2 percentage points above the percentage increase for the class is appropriate because it balances the need for mailers to pay reasonable rates with the need for the Postal Service to achieve cost reductions.²²⁷

The Commission has demonstrated that price increases are part of a potential solution to remedying non-compensatory products. For example, in the FY 2018 ACD, the Commission directed the Postal Service to increase USPS Marketing Mail Flats prices by at least 2 percentage points above the average price increase for the USPS Marketing Mail class. FY 2018 ACD at 47. The Commission acknowledged that the directive alone would not remedy the cost coverage issue and urged the Postal Service to aggressively reduce USPS Marketing Mail Flats' costs. *Id.* The Commission also strongly recommended that the Postal Service increase USPS Marketing Mail Parcels prices by at least 2 percentage points above the average price increase for the USPS Marketing Mail class. *Id.* at 78. The Commission concluded that the price adjustments are likely to have positive results on cost coverage. *Id.* at 71.

In response to the Commission's proposal in Order No. 4258, the Public Representative states that additional rate authority could be made available to non-compensatory products by adjusting the price cap for exogenous factors. PR Comments at 59. However, as past rate cases have shown, the Postal Service has had enough authority to increase rates for non-compensatory products but has not chosen to do so by more than the required amount in accordance with Commission directives. See FY 2018 ACD at 47, 53.

²²⁷ The proposed rate increase must comply with the other rate setting criteria proposed by the Commission in this Order.

The Commission also declines to adopt the suggestion of the Postal Service to target specific products based on criteria such as the number of years a product has been persistently non-compensatory. The goal of the proposed price increase is to increase revenue for products that fail to cover costs because these products threaten the financial integrity of the Postal Service. Therefore, the Commission finds that the only criterion should be that the product failed to cover its costs. If a non-compensatory product later becomes compensatory, the product is no longer subject to the required price increase. Moreover, and as stated earlier, the majority of non-compensatory products as of the most recent ACD have historically failed to cover their attributable costs. See Section VI.A.1., *supra*. Thus, even if the Commission adopted the Postal Service's suggestion, most non-compensatory products would nonetheless be subjected to the proposed price increases.

Similarly, the Commission declines to adopt MH and NAAD's suggestion that the specific benchmarks and criteria for efficiency be developed for flat-shaped mail. The Commission believes that the efficiency issues affecting flat-shaped mail are unique and best explored through the ACD and the flats rulemaking docket. See, e.g., Docket No. RM2018-1.

Finally, the Commission declines to explicitly adopt the Postal Service's suggestion that the "no price reduction" rule should apply at the product level rather than at each price level. Given that the Commission determines at the product level whether a product is non-compensatory, the Commission will allow adjustments at the rate cell level as long as the product cost coverage does not decrease. Although the Commission will allow these adjustments in practice, it does not find that it warrants a change to the rule.

4. Commission Proposal

Proposed Subpart G is added to 39 C.F.R. part 3010 to address the issue of non-compensatory products and classes. Proposed § 3010.220 defines non-compensatory products as those for which the Commission has determined that the attributable costs for the product exceed the product's revenue.

Proposed § 3010.221 sets forth the rate setting criteria for non-compensatory products in classes for which overall class revenue exceeds overall class attributable cost.

Existing § 3010.20(e) is replaced by proposed §§ 3010.127(b) and 3010.129(g), which prohibit the reduction of rates of non-compensatory products.

In addressing non-compensatory products, the Commission must balance the objectives and take into consideration the views of the stakeholders. The proposed rate setting criteria applicable to non-compensatory products is necessary to achieve Objectives 1 and 8. See Order No. 4257 at 134-142; 230-236. Products that do not generate revenues that cover their attributable costs contribute to the system's inability to achieve reasonable and efficient prices. Gradual above-average increases to the prices of non-compensatory products will bring those products to full cost coverage over time and thereby achieve reasonable and efficient rates as envisioned by the PAEA. This proposed approach is also consistent with the Commission's evaluation of the ratemaking system in Order No. 4257.

B. Non-Compensatory Classes

1. Introduction

Non-compensatory classes are non-compensatory because they are dominated by non-compensatory products. Non-compensatory classes create unique problems in a ratemaking system that is limited to inflation-based increases applied at the class

level. 39 U.S.C. § 3622(d)(2)(A). Unless the Postal Service is able to constrain the average cost for the class as a whole to below the level of inflation, the cost coverage for the class cannot improve.

The Periodicals class has not covered its attributable costs since the enactment of the PAEA. FY 2018 ACD at 41. The Periodicals class consists of only two products—In-County Periodicals and Outside County Periodicals—and each of those products is non-compensatory. *Id.* at 43. Over the course of the PAEA era, cost coverage for the Periodicals class has generally declined—from 83.0 percent in FY 2007 to 67.5 percent in FY 2018. *Id.* at 40. The low cost coverage for the Periodicals class has resulted in a negative contribution of more than \$6.7 billion since FY 2007. *Id.* at 42. Also, the Package Services class contribution was negative from FY 2009 through FY 2012. Order No. 4257 at 232-233.

If a non-compensatory product is part of a class that is compensatory on the whole, then the rates for the non-compensatory product can be increased by a greater percentage than the compensatory products in that class while keeping the overall class increase within the price cap. But if, as with Periodicals, the entire class is non-compensatory, there is no opportunity to rebalance rates among products, because increasing the rates for one product generally requires offsetting decreases to the rates for other products. Additionally, there are no products with positive cost coverage against which such offsets can be made.²²⁸ In Order No. 4257, the Commission stated that non-compensatory mail classes threaten the financial integrity of the Postal Service. Order No. 4257 at 274. Accordingly, the Commission proposed modifications to the system of ratemaking that will grant additional rate authority to non-compensatory

²²⁸ The Commission previously stated that, as the Public Representative recognized, the only exception to this general rule occurs when changes in the CPI-U index result in an increase in the cap for the class. Order No. 4258 at 82 n.90. However, for the Periodicals class, in particular, these relatively small increases in the cap do not provide enough headroom for price increases that could provide meaningful improvement to the overall cost coverage for the class. *Id.*

classes of mail in order to improve the cost coverage for such classes and move prices towards full cost coverage. See Order No. 4258 at 84-85.

Because improved cost coverage for products within non-compensatory classes cannot be attained by rebalancing rates among products within such classes, the Commission proposed expanding pricing authority for non-compensatory classes in order to allow for additional product-level rate increases within such classes. *Id.* at 84. If the attributable cost for an entire class exceeds revenue for that class, the Commission proposed to provide 2 percentage points of additional rate authority for the class. *Id.* The Commission proposed that the Postal Service, when seeking to raise rates for a non-compensatory class, must use all available rate authority for non-compensatory classes as part of the first generally applicable rate adjustment in a calendar year. *Id.* at 84-85.

If there are any products within a non-compensatory class for which product-level revenue exceeds the product-level attributable cost, then prices for such products may only be increased up to the amount of the class average. *Id.* at 85. Currently, no Postal Service products fit this description. Moreover, the Commission proposed to prohibit the reduction of rates for non-compensatory products. *Id.*

2. Comments

DFS states that the Commission's proposed regulations seek to accomplish the goal of requiring all classes to cover all of their attributable costs.²²⁹ DFS states that it supports that goal. DFS Comments at 9.

²²⁹ Comments of Discover Financial Services, March 1, 2018, at 9 (DFS Comments).

However, many of the comments opposing the Commission's proposal for non-compensatory products were repeated for non-compensatory classes.²³⁰ SIIA comments that "Congress recognized Periodicals as a loss leader, creating value for consumers from the Postal Service, while contributing significantly—if not completely—to the Postal Service['s] overall costs." SIIA Comments at 3. SIIA also states the proposal ignores the reality that a reduction in volume within the Periodicals class will also lead to a reduction in volume of USPS Marketing Mail and First-Class Mail. *Id.* at 6.

However, MH and NAAD state that they agree with other commenters that the price cap directly frustrates any Postal Service efforts to bring non-compensatory mail to 100-percent cost coverage.²³¹ They explain that "[a]lthough Periodicals ratepayers may face a difficult situation if their prices rise faster (e.g., at 1% more) than other rates, their severe cost coverage shortfall cannot be ignored, and perpetuating it (such as by avoiding above-CPI increases) would be just as unfair to other ratepayers as excessive increases would be to them." MH/NAAD Reply Comments at 3.

Several commenters propose alternative solutions for non-compensatory mail classes. In addition to requiring the 2-percent rate increase annually, MH and NAAD suggest that rate increases should be placed on the least efficient mail with the lowest cost coverages, and the additional 2 percent should be enforced even if the Postal Service does not seek a general rate increase. MH/NAAD Comments at 9.

SIIA suggests that the Commission utilize the exigent surcharge capability to provide additional revenue. SIIA Comments at 12. Alternatively, SIIA recommends that

²³⁰ See note 217, *supra*; see also SIIA Comments at 4, 8-10; Comments of the Elks Magazine, March 2, 2018, at 1-2 (Elks Magazine Comments); Reply Comments of Quad/Graphics, March 30, 2018, at 1-2. Elks Magazine filed a motion for late acceptance of its comments. Motion for Late Acceptance, March 2, 2018. The motion is granted.

²³¹ Reply Comments of Mailers Hub LLC and the National Association of Advertising Distributors, Inc., March 30, 2018, at 3 (MH/NAAD Reply Comments).

the Commission provide for a delayed implementation of the proposed changes and a clear recommendation to Congress and the Office of Management and Budget that the changes will not take effect unless Congress chooses not to act or fails to reach consensus on broader legislative reforms. *Id.* at 13.

ANM *et al.* recommend that the additional authority for non-compensatory classes should not be applied to an individual product in that class, if that product's revenue exceeds its attributable cost.²³²

The Postal Service states that, with respect to underwater class authority, the Commission should clarify that all new rate authority will be available for the first price adjustment following the new rules. Postal Service Comments at 139. In its reply comments, the Postal Service states that the additional authority for non-compensatory classes may be appropriate for a trial period. Postal Service Reply Comments at 101-102. The Postal Service requests that the Commission provide a robust, qualitative explanation of why the additional authority is consistent with the objectives and factors. *Id.* The Postal Service also suggests that the Commission should clarify the rules regarding compensatory products in non-compensatory classes and, in particular, the Commission should preserve pricing flexibility for those products. *Id.* at 105-107.

The Public Representative states that "2 percent would do very little to reduce the large negative contribution of Postal Service Periodicals revenue." PR Comments at 29. The Public Representative recommends a one-time rate reset for Periodicals that would allow the Postal Service to collect rates as close as possible to estimated total costs. *Id.* at 41.

²³² See ANM *et al.* Comments at 9. ANM *et al.* also argue that Outside County Carrier Route Periodicals is compensatory. *Id.* at 9, 107-108. Although several commenters respond to this contention, the Commission will not review this assertion in this proceeding. The Commission identified the non-compensatory products, as determined by the FY 2018 ACD, in Section VI.A.1., *supra*.

3. Commission Analysis

In Order No. 4258, the Commission found that not changing the price cap structure for the non-compensatory classes would continue the trend of negative class contribution and continue to hinder the achievement of Objective 1 (maximize incentives to increase pricing efficiency), Objective 5 (assure adequate revenues, including retained earnings, to maintain financial stability), and Objective 8 (establishing and maintaining reasonable rates).²³³

The Commission proposes one change to its previous proposed solution for non-compensatory classes; that the 2 percentage points of additional rate authority for non-compensatory classes be optional. The Commission's proposed solution does not mandate immediate full cost coverage for non-compensatory classes, but it does seek to narrow the coverage gap and move prices towards full cost coverage over time. At a minimum, the proposal seeks to stop the worsening cost coverages. Further, given the substantial increase needed for the Periodicals class to cover its attributable cost, the proposed 2-percentage point increase represents an appropriate mechanism for improving cost coverage while simultaneously maintaining stability and predictability in rates, as required by Objective 2. See 39 U.S.C. § 3622(b)(2). Both the Postal Service and the mailing community will be informed, through the Commission's announcement, which classes are non-compensatory and thus may be subject to a 2-percentage point rate increase in class-level rate authority.

The Commission determines that an increase in the Postal Service's rate authority of an additional 2 percentage points is appropriate because it balances the need for mailers to pay a more reasonable rate with the need for the Postal Service to achieve cost reductions and improvements in operational efficiency. The Commission

²³³ See Order No. 4258 at 85; Order No. 4257 at 134-142, 159-178, 230-236; 39 U.S.C. § 3622(b)(1), (5), and (8).

performed a scenario-based analysis to determine the appropriate level of additional price authority for Periodicals. In Table VI-4, the most recent CPI-U projections were combined with unit attributable cost growth rates from the most recent 10 years to estimate changes in cost coverage assuming that prices are increased by 1 percent, 2 percent, or 3 percent above the average rate increase.²³⁴ The CPI-U change is projected to be 1.818 percent per year for the next 5 years, while the increase in the unit attributable cost of Periodicals was 1.803 percent per year for the last 10 years. Table VI-4 assumes that the next 5 years will experience the same unit attributable cost change and that the CPI-U will conform to projections. Each year, in addition to the CPI-U rate authority, density authority, retirement authority, and performance-based rate authority, either 1 percent, 2 percent, or 3 percent of additional rate authority is applied to estimate the increase in revenue. Table VI-4 below details the resulting estimated cost coverages for Periodicals.

Table VI-4
Periodicals Cost Coverage Scenarios

	1.0%		2.0%		3.0%	
Year	Coverage	Increase	Coverage	Increase	Coverage	Increase
Year 0	68.0%	0.0%	68.0%	0.0%	68.0%	0.0%
Year 1	70.7%	5.9%	71.3%	6.9%	72.0%	7.9%
Year 2	73.5%	5.9%	74.9%	6.9%	76.3%	7.9%
Year 3	76.5%	5.9%	78.7%	6.9%	80.9%	7.9%
Year 4	79.5%	5.9%	82.6%	6.9%	85.7%	7.9%
Year 5	82.7%	5.9%	86.7%	6.9%	90.9%	7.9%
Total		29.5%		34.5%		39.5%

²³⁴ The unit attributable costs by product are only available for the most recent 10 years due to the product list change associated with the PAEA and concurrent changes to cost reporting. The Postal Service did not report the unit attributable costs for each and every PAEA product until FY 2008. See Library Reference USPS-FY08-1.

In the scenarios detailed in Table VI-4, Periodicals would experience a 5-year cumulative price increase of between 29.5 and 39.5 percent.²³⁵ In the scenario where prices are increased 7.9 percent per year, the estimated cost coverage remains below 100 percent 5 years after implementation. As explained above, Table VI-4 contains the assumption, based on historical data, that unit attributable costs will continue to increase at about the same rate as the CPI-U. The Commission changes this assumption in its calculation in Table VI-5 below.

**Table VI-5
Periodicals Full Cost Coverage Scenario**

	1.0%		2.0%		3.0%	
Year	Coverage	Increase	Coverage	Increase	Coverage	Increase
Year 0	68.5%	0.0%	68.5%	0.0%	68.5%	0.0%
Year 1	71.8%	5.9%	72.5%	6.9%	73.2%	7.9%
Year 2	75.3%	5.9%	76.7%	6.9%	78.2%	7.9%
Year 3	78.9%	5.9%	81.2%	6.9%	83.5%	7.9%
Year 4	82.8%	5.9%	85.9%	6.9%	89.2%	7.9%
Year 5	86.8%	5.9%	90.9%	6.9%	95.3%	7.9%
Total	29.5%		34.5%		39.5%	

In Table VI-5, unit attributable costs are assumed to increase at 1.0 percent per year, or 0.8 percent below the historical average. If the Postal Service increases prices at 2 percent above the class average and reduces the growth in unit attributable cost, the cost coverage exceeds 90 percent after 5 years.

Because the 2-percent increase brings cost coverage close to 100 percent after 5 years, the Commission maintains its proposed level of additional rate authority for

²³⁵ The 5-year cumulative increases are greater than the sum of the annual increases due to the effects of compounding.

non-compensatory classes.²³⁶ The Commission specifically proposes 2 percent because, with cost reductions, it would bring cost coverage above 90 percent while keeping the cumulative price increase under 35 percent. However, after consideration of the comments, the Commission proposes that the 2 percentage points of additional rate authority for non-compensatory classes be optional.

In particular, the Commission notes that several commenters agreed with allowing the Postal Service additional authority for non-compensatory classes but recommended that the additional authority be provided on a one-time or temporary basis.²³⁷

The Commission finds that the rate reset proposed by the Public Representative results in 35 to 40 percent in additional authority and immediately prioritizes adequate revenue (Objective 5) over stability and reasonableness in rates (Objectives 2 and 8).²³⁸ Additionally, the Commission finds that MH and NAAD's proposal restricts the Postal Service's pricing flexibility by instituting price increase parameters below the product level.

The Commission also declines to adopt the recommendations suggested by SIIA. Although the exigent surcharge capability would provide additional revenue, the exigency provision was intended to provide relief to the Postal Service in cases of "unexpected and extraordinary circumstances."²³⁹ However, it is not clear that the exigent provisions would apply in this case, given that the Periodicals class has not

²³⁶ The proposed rate increase must comply with the other rate setting criteria proposed by the Commission in this Order.

²³⁷ See PR Comments at 41; SIIA Comments at 12; Postal Service Reply Comments at 102.

²³⁸ See Order No. 4257 at 16-18 (discussing that no individual objective should be elevated above another when the objectives are analyzed).

²³⁹ See Order No. 4257 at 241 (quoting S. Rep. No. 108-318 at 11).

covered its attributable costs since the enactment of the PAEA. In regards to SIIA's suggestion that the Commission delay implementation of its proposal and defer to Congress, the Commission finds that cost coverage would further decline under such a strategy.²⁴⁰

The Postal Service suggests that the 2 percent additional amount may be appropriate on a trial basis. The Postal Service notes that while potential price increases may close the cost coverage gap faster, they may also have "unexpected effects on volume and revenue from Periodicals, as well as from other products mailed by the Periodicals industry." Postal Service Reply Comments at 102. The Commission declines to provide the additional authority on a trial basis. However, the Postal Service's caution about unknown effects appears to be in alignment with other commenters, particularly those of the Public Representative and SIIA who suggest one-time increases. The Commission agrees with the Postal Service that it is in the best position to "assess demand and other market forces." *Id.* at 31. The Commission finds that the Postal Service should have flexibility to determine if and when this additional authority should be used.

The failure to cover costs has persisted prior to the enactment of the PAEA. Periodicals continue to fail to cover costs despite the fact that its unit attributable costs have not risen as drastically as costs for some non-compensatory products. For example, the average increase in unit attributable cost of Periodicals was 1.8 percent per year for the last 10 years, in contrast to 4.4 percent per year for USPS Marketing Mail Flats.

²⁴⁰ See Order No. 4258 at 85 (finding that making no change to the system would continue the trend of negative class contribution).

Because of the caution of the commenters who support the additional authority, the Commission proposes that the Postal Service may use the additional authority at its discretion when adjusting rates for non-compensatory classes.

Moreover, for both non-compensatory products and classes, the Commission revises the proposal such that the Commission may identify non-compensatory classes outside of the ACD. The Commission finds that connecting the identification of non-compensatory products and classes and the availability of the rate authority to the ACD may be too restrictive. Although some products are historically non-compensatory year after year, the Commission recognizes that the list may change periodically. Not tying the Commission's identification of non-compensatory products to the ACD allows flexibility should a non-compensatory product cover its costs sooner rather than later. Additionally, as suggested by the Postal Service, the Commission clarifies that the additional rate authority be made available for the first price adjustment following the new rules. This revision allows the Postal Service to address the issue of non-compensatory products and classes without waiting for the ACD.

Finally, both the Postal Service and ANM *et al.* seek clarification on how the Commission intends to address compensatory products within a non-compensatory class. As proposed in Order No. 4258, prices for compensatory products within a non-compensatory class may only be increased up to the amount of the class average.²⁴¹ The Commission declines to adopt ANM *et al.*'s recommendation that the additional authority for non-compensatory classes shall not be applied to an individual product in that class, if that product's revenue exceeds its attributable cost. The Commission finds that limiting the price increases for compensatory products to the amount of the class average strikes the appropriate balance between allowing the Postal Service pricing flexibility and maintaining reasonable rates.

²⁴¹ See Section VI.B.3., *supra*; Order No. 4258 at 85.

4. Commission Proposal

Proposed subpart G is added to 39 C.F.R. part 3010 to address the issue of non-compensatory products and classes. Proposed § 3010.220 defines non-compensatory classes as those for which attributable costs for the class exceed revenue derived from the class as determined by the Commission.

Proposed § 3010.222(a) provides for 2 percentage points of additional rate authority for a non-compensatory class. Proposed § 3010.22(b) describes the requirements applicable to the availability, calculation, and use of the 2 percentage points of additional rate authority for a non-compensatory class.

Existing § 3010.20(e) is replaced by proposed §§ 3010.127(b) and 3010.129(g), which prohibit the reduction of rates of non-compensatory products.

The proposed increase in class-level rate authority applicable to non-compensatory classes is necessary to achieve Objectives 1 and 8. See Order No. 4257 at 134-142, 230-236. Non-compensatory classes are dominated by non-compensatory products. For these classes to generate revenues that cover their attributable costs, the products within them must have prices that are reasonable and efficient. An increase in the class-level rate authority for non-compensatory classes, should the Postal Service elect to use it, will gradually move the prices of non-compensatory products within non-compensatory classes towards full cost coverage, thereby achieving reasonable and efficient rates as envisioned by the PAEA. This proposed approach is necessary to achieve Objectives 1 and 8 and is consistent with the Commission's analysis of the other objectives in Order No. 4257. *Id.* Because the proposed approach is optional, the Postal Service maintains pricing flexibility, pursuant to Objective 4. *Id.* at 91-97.

VII. WORKSHARE DISCOUNTS

A. Introduction

As it relates to workshare discounts,²⁴² in Order No. 4258, the Commission noted that Objective 1's goal of pricing efficiency could be achieved when "prices adhere as closely as practicable" to ECP.²⁴³ Under ECP, pricing efficiency is achieved when workshare discounts are equal to avoided costs and produce passthroughs equal to 100 percent. Order No. 4258 at 89. As part of Order No. 4257, the Commission concluded that the Postal Service failed to set most workshare discounts in accordance with ECP during the 10 years following the enactment of the PAEA. Order No. 4257 at 136-138.

The Commission identified and proposed to phase out the two practices impeding pricing efficiency: workshare discounts set substantially below avoided costs and workshare discounts set substantially above avoided costs. Order No. 4258 at 93. After consideration of comments, the Commission proposed the use of passthrough bands—ranges with upper and lower limits—in order to evaluate workshare discount compliance.²⁴⁴ The proposed use of passthrough bands sought to maximize efficiency (Objective 1) by incentivizing the Postal Service to set passthroughs closer to 100 percent while also allowing pricing flexibility (Objective 4) by giving the Postal Service

²⁴² A workshare discount is a discount that a mailer receives for additional preparation of a mailpiece, such as presorting, prebarcoding, handling, or transportation, and relieves the Postal Service of the cost of performing those activities. Order No. 4257 at 130; Order No. 4258 at 19; 39 U.S.C. § 3622(e)(1).

²⁴³ Order No. 4258 at 87; 39 U.S.C. § 3622(b)(1). Under ECP, "prices are most efficient when workshare discounts are set equal to avoided costs." See Order No. 4257 at 135-136. "When a discount equals its avoided cost, the Postal Service neither gives too great a discount (*i.e.*, the discount exceeds what it costs the Postal Service to perform the work) nor too little a discount (*i.e.*, the discount is less than what it costs the Postal Service to perform the work, and although a mailer could perform the work at a lower cost than the Postal Service, it may not if the cost to the mailer for performing the work exceeds the amount of the discount)." *Id.* at 131.

²⁴⁴ Order No. 4258 at 93. The Commission proposed two bands, one for Periodicals and one for all other classes. *Id.*

discretion to set passthroughs within the applicable band.²⁴⁵ These parameters were also designed to accommodate the specific concerns referenced in the PAEA related to excessive workshare discounts. Order No. 4258 at 93; see 39 U.S.C. § 3622(e).

The Commission's initial approach included percentage passthrough bands ranging from 75 percent to 125 percent for Periodicals and 85 percent to 115 percent for all other classes. Order No. 4258 at 93. The bands would be subject to a 3-year grace period, providing the Postal Service with time to bring workshare discounts within applicable ranges and into compliance. *Id.* at 95. For all existing workshare discounts, the grace period would begin on the effective date of the proposed rules. *Id.* For a workshare discount established after the proposed rules became effective, the grace period would begin on the date that the new discount was established. *Id.* After the grace period expired, any workshare discount outside the applicable band would be found non-compliant. *Id.* at 96.

The Commission refines its initial approach by dispensing with the 3-year grace period and instead providing an incremental path to bring existing workshare discounts closer to ECP. The revised approach would prohibit workshare discounts that are equal to avoided cost from being changed (that is, set below or above avoided cost). Moreover, the revised approach would prohibit workshare discounts that are below avoided cost from being reduced and workshare discounts that exceed avoided cost from being increased. The Commission also permits the Postal Service to propose to set a workshare discount below its avoided costs or exceeding its avoided costs only under certain circumstances.

The Commission sought to codify its initial approach in proposed subpart I of part 3010 of the Code of Federal Regulations. As part of the instant Order, the Commission proposes to codify its revised approach in subpart J of part 3010 of the Code of Federal

²⁴⁵ *Id.*; see 39 U.S.C. § 3622(b)(1) and (4).

Regulations. The following discussion summarizes the comments received concerning the Commission's initial approach, provides analysis, and describes the resulting changes made to the proposed rules.

B. Comments

1. Overview

Several commenters support the Commission's initial approach of using passthrough bands subject to a 3-year grace period, with some qualifications and suggested revisions.²⁴⁶ GCA and the Postal Service reiterate their objections and, in the alternative, suggest revisions.²⁴⁷ RR Donnelly Logistics (RR Donnelley) objects and asks the Commission to reconsider its proposal entirely.²⁴⁸ Below, the Commission summarizes each commenter's general remarks on the Commission's initial approach and suggested adjustments to the passthrough bands and grace period.

General remarks. Multiple commenters agree with the Commission's previous finding²⁴⁹ that the Postal Service had not used its pricing authority to improve efficiency under Objective 1. Many support the Commission's approach to setting workshare

²⁴⁶ See ABA Comments at 12-13; ANM *et al.* Comments at 56 n.34, 97; ANM *et al.* Reply Comments at 2-3, 72-74; MH/NAAD Comments at 10; NPPC *et al.* Comments at 6-7, 40-45; NPPC *et al.* Reply Comments at 3, 45-47; Pitney Bowes Comments at 2-13; Reply Comments of Pitney Bowes Inc., March 30, 2018, at 1-8 (Pitney Bowes Reply Comments); Valpak Comments at 18-19; Valpak Reply Comments at 19-23.

²⁴⁷ GCA Comments at 2-3, 19-27, 34; Postal Service Comments at 146-148; Postal Service Reply Comments at 107-112. GCA and the Postal Service reiterate their position that workshare discounts are not within the scope of this proceeding (that is, subject to neither review nor potential regulatory action). See GCA Comments at 1; Postal Service Reply Comments at 108 n.285, 111. The Commission addresses comments related to its statutory authority and the scope of its 39 U.S.C. § 3622(d)(3) review in Sections III.B.3. and III.C.3., *supra*.

²⁴⁸ Comments Received from RR Donnelley Logistics, March 5, 2018, at 1 (RR Donnelley Comments).

²⁴⁹ See Order No. 4257 at 136-138.

discounts more efficiently and consistent with ECP by bringing workshare discounts closer to avoided costs. However, there are commenters who disagree with the proposed rules pertaining to workshare discounts.

ABA supports the Commission's findings related to workshare discounts, noting that "[w]orkshare discounts set substantially above or substantially below avoided costs are problematic because they send inefficient price signals to mailers and therefore reduce productive efficiency in the postal sector."²⁵⁰ It states that efficient workshare discounts that reflect the full amount of their avoided costs lower the prices for the worksharing mailers. ABA Comments at 13. ABA notes that this allows mail to remain attractive and will stimulate volume, stem erosion, and help the Postal Service to outsource mail processing operations, which will minimize costs and maximize operational efficiency. *Id.*

ANM *et al.* assert that the proposal would lead to improved pricing signals for mailers to determine whether to engage in worksharing activities. ANM *et al.* Comments at 56 n.34. ANM *et al.* encourage the Commission to move forward with the proposed rules to require the Postal Service to pass through as near as possible to 100 percent of the avoided costs, consistent with ECP. ANM *et al.* Reply Comments at 3-4. In addition, they contend that aligning the workshare discounts that are below avoided costs would result in significant savings to the Postal Service without requiring any additional capital expenditures.²⁵¹ Finally, ANM *et al.* opine that codifying the proposed rules would only be the first step towards improving efficiency and would not offset the additional rate authority. ANM *et al.* Comments at 97.

MH and NAAD generally support pursuing 100-percent passthroughs for all mail through annual incremental changes for 10 years. MH/NAAD Comments at 10.

²⁵⁰ ABA Comments at 12 (quoting Order No. 4258 at 89 (internal marks omitted)).

²⁵¹ *Id.* at 46; ANM *et al.* Comments at 94-97.

Overall, they urge that worksharing and any related rules aim to enable the production, processing, and delivery of mail at the lowest combined cost, which includes mailer cost, postage, and Postal Service cost. *Id.*

NPPC *et al.* commend the Commission for placing greater emphasis on ECP in setting workshare discounts. NPPC *et al.* Comments at 7. NPPC *et al.* observe that the shift in mail mix to more workshared mail means that the proposed rules would benefit the Postal Service. *Id.* at 12. They note that the Postal Service may realize cost savings if it prices in accordance with ECP. NPPC *et al.* Reply Comments at 30. NPPC *et al.* endorse the proposed rules as being fully consistent with Objectives 1, 5, and 8.²⁵²

Pitney Bowes supports the underlying Commission finding that the existing system is not maximizing incentives to reduce costs and increase efficiency and that the workshare discount rule changes are necessary. Pitney Bowes Comments at 4. Pitney Bowes agrees that the proposal would promote operational and pricing efficiency to the benefit of the Postal Service, mailers, and consumers. *Id.* at 2.

However, the Postal Service objects to the proposed rules, stating that rigid compliance bands would inhibit the Postal Service's pricing flexibility and would not be necessary to achieve Objective 1. Postal Service Comments at 146-147. It states that passthroughs can shift significantly due to non-pricing factors such as changes in costing methodology or changes in mail mix and operational efficiencies. *Id.* at 147. The Postal Service asserts that creating more reasons to adjust prices due to such exogenous factors erodes the achievement of Objective 2. *Id.*

²⁵² NPPC *et al.* Comments at 41; NPPC *et al.* Reply Comments at 47.

GCA asserts no changes to the workshare discount rules are necessary or advisable. GCA Comments at 2-3. Setting aside its reservations about changing the existing workshare discount rules,²⁵³ GCA acknowledges, however, that the Commission's proposed approach is sound and that ECP is the correct basis for thinking about how to calculate workshare discounts. GCA Comments at 19.

Characterizing the initial approach as arbitrary, RR Donnelley urges the Commission to reconsider. RR Donnelley Comments at 1.

Passthrough bands. Multiple commenters suggest adjusting the upper and lower limits on the percentage passthrough bands that were initially proposed in Order No. 4258 and generally discuss using either narrower symmetrical passthrough bands or asymmetrical passthrough bands.

ABA, MH and NAAD, NPPC *et al.*, and Pitney Bowes support setting a narrower symmetrical percentage passthrough band, ranging from 95 percent to 105 percent.²⁵⁴ The Postal Service and Valpak oppose these suggestions.²⁵⁵

ABA suggests that setting narrower passthrough bands for all classes other than Periodicals would "maximize" incentives to reduce costs and improve efficiency as required by Objective 1. ABA Comments at 12. MH and NAAD recommend applying

²⁵³ GCA maintains its view that the PAEA does not grant the Commission authority to substantially alter the system governing workshare discounts. GCA Comments at 1 (citing 2017 GCA Comments, sections V-VI).

²⁵⁴ ABA Comments at 12; MH/NAAD Comments at 10; NPPC *et al.* Comments at 42-43; Pitney Bowes Comments at 11-13.

²⁵⁵ Postal Service Reply Comments at 107-108 (citing ABA Comments at 12-13; MH/NAAD Comments at 10; NPPC *et al.* Comments at 42-45; Pitney Bowes Comments at 10-13); Valpak Reply Comments at 20-22 (citing Pitney Bowes Comments at 10; NPPC *et al.* Comments at 42-43).

the suggested narrowed passthrough band to all mail in 10 years, using bands that will contract by 1 or 2 percentage points²⁵⁶ each year. MH/NAAD Comments at 10.

NPPC *et al.* maintain that narrowing the band for all classes of mail other than Periodicals is supported by the Postal Service's recent history during the PAEA era of setting workshare discounts substantially below avoided costs, with particular focus on certain workshare discounts that NPPC *et al.* deem "vitally important." NPPC *et al.* Comments at 42-43. They state that a narrower band would be more efficient and send more cost-effective pricing signals. *Id.* at 43.

Additionally, Pitney Bowes asserts that the 30-percentage point range is too permissive, especially for mature, high-volume automation letter mail products in First-Class Mail and USPS Marketing Mail. Pitney Bowes Comments at 10. Pitney Bowes asserts that a narrower percentage passthrough band is required by Objective 1, would move workshare discounts closer to ECP, and would mitigate concerns regarding excessive passthroughs. *Id.* at 11. In addition, it contends that narrowing the bands would not unduly constrain pricing flexibility, reading Objective 4 in concert with Factor 7, because the PAEA acknowledged using pricing flexibility as a means to encourage increased mail volume and operational efficiency. *Id.* at 12.

In reply, the Postal Service counters that narrower bands aim for productive efficiency but do not reflect practical implementation realities. Postal Service Reply Comments at 108. The Postal Service states that a small absolute change in unit cost may have a significant percentage effect on the passthrough. *Id.* It maintains that narrower bands could result in sub-optimal pricing, such as significant decreases in

²⁵⁶ Percentage point refers to the numerical difference between two different percent values. For example, if a passthrough band of 75 to 125 percent were to contract by 2 *percentage points* a year (as MH and NAAD suggest), the passthrough band would be 77 to 123 percent after the first year. Alternatively, percent refers to the rate of change or the increase or decrease considered as part of a 100-percent total. For example, if a passthrough band of 75 to 125 percent were to contract by 2 *percent* a year, the passthrough band would be 76.5 to 122.5 percent after the first year.

discounts to approach 100-percent cost avoidance. *Id.* The Postal Service asserts that this could harm other mailers by resulting in increased prices to offset the revenue lost from the worksharing mailers. *Id.* The Postal Service contends that either result would be contrary to 39 U.S.C. § 3622(e)(3). *Id.* The Postal Service reiterates its view that narrower bands can severely constrain the pricing flexibility allowed by Objective 4 and that convergence on a single price point would abolish it altogether.²⁵⁷

Valpak also opposes the suggestions to narrow the passthrough bands.²⁵⁸ Valpak counters that the suggested narrower band is so inflexible that it would unnecessarily and unwisely force pricing changes based on potentially incorrect cost analyses. Valpak Reply Comments at 20.

GCA suggests that the Commission modify the upper and lower limits of the bands to be asymmetrical, allowing for greater tolerance of workshare discounts that do not exceed the cost avoided by the Postal Service. GCA Comments at 24. For Periodicals, GCA recommends requiring passthroughs to range between 65 percent and 115 percent. *Id.* at 26. For all other classes, GCA recommends requiring passthroughs to range between 75 percent and 105 percent. *Id.* GCA acknowledges that rulemakings may be needed to adjust the bands in the future and observes that such changes need not be done as part of the future reviews of the system. *Id.* at 26 n.1. While reserving its general opposition to the Commission's regulation of workshare discounts, the Postal Service endorses GCA's suggestion. Postal Service Reply Comments at 110-111. Pitney Bowes opposes GCA's suggestion, noting the negative effects on pricing and operational efficiency of setting workshare discounts substantially below avoided costs. Pitney Bowes Reply Comments at 1, 5.

²⁵⁷ *Id.*; see Postal Service Comments at 147.

²⁵⁸ Valpak Reply Comments at 20-22 (citing Pitney Bowes Comments at 10; NPPC *et al.* Comments at 42-43).

Three-year grace period. NPPC *et al.* object to the 3-year grace period, asserting that such a “phase-in” is unnecessary. NPPC *et al.* Comments at 44. NPPC *et al.* state that the delay would be “harmful” and perpetuate behavior contrary to Objective 1 during the 3 additional years. *Id.* They assert that immediate implementation of the bands would not impede rate design and would instead benefit the Postal Service. *Id.* They state this is because efficient workshare discounts benefit the Postal Service as more-finely workshared pieces contribute more per piece than less-finely workshared pieces. *Id.* In addition, NPPC *et al.* indicate that even large discount changes “[are] not necessarily a problem” and note the recent reduction in the passthrough for First-Class Mail Automation 5-Digit Flats in Docket No. R2018-1 from 115.7 percent to 100 percent, shrinking the discount from \$0.184 to \$0.119 with a corresponding hike in the final rate.²⁵⁹ Furthermore, NPPC *et al.* state that if rate shock remains a concern, “the Postal Service would retain the ability to invoke the statutory exceptions in Section 3622(e).” NPPC *et al.* Comments at 45. NPPC *et al.* contend that new workshare discounts should be set at or near the best estimate of avoided costs and that a market test can be used to test out a new workshare discount. *Id.*

Pitney Bowes suggests clarifications to the 3-year grace period. Pitney Bowes Comments at 13. Specifically, it suggests that the 3-year grace period apply only to the existing discounts that are not currently in compliance.²⁶⁰ Pitney Bowes asserts that allowing compliant discounts to fall outside the band and then providing those discounts with a 3-year grace period would be inconsistent with the purpose of the proposed rules and Objective 1. Pitney Bowes Comments at 13.

²⁵⁹ *Id.* at 44-45 (citing Docket No. R2018-1, Order on Price Adjustments for First-Class Mail, USPS Marketing Mail, Periodicals, Package Services, and Special Services Products and Related Mail Classification Changes, November 9, 2017, at 12 (Order No. 4215)).

²⁶⁰ *Id.*; Pitney Bowes Reply Comments at 7.

The Postal Service opposes the suggestion that compliance with workshare bands be required immediately. Postal Service Reply Comments at 107-108. Instead, the Postal Service requests that the 3-year grace period be postponed to start with the implementation date of the first general price change after the effective date of the new rules, thereby providing the Postal Service with four opportunities to bring passthroughs within applicable bands. Postal Service Comments at 148.

NPPC *et al.* and Pitney Bowes oppose the extension requested by the Postal Service.²⁶¹ Pitney Bowes contends that the Postal Service fails to justify the requested extension and observes that, while *ad hoc* exceptions may be warranted, wholesale delay would harm pricing and operational efficiency. Pitney Bowes Reply Comments at 7. Similarly, NPPC *et al.* state that delaying the full implementation of ECP will harm efficiency. NPPC *et al.* Reply Comments at 46. Like Pitney Bowes, NPPC *et al.* note that the Postal Service should be permitted to invoke one of the statutory exceptions, if applicable. *Id.*

In its reply comments, the Postal Service makes an additional request that the Commission allow the Postal Service to make a case-specific showing to restart the grace period if a passthrough strays beyond a level that the Postal Service can reasonably adjust back into compliance in a single rate adjustment proceeding. Postal Service Reply Comments at 112.

Below, the Commission separately summarizes suggestions specific to workshare discounts that are below avoided costs, suggestions specific to workshare discounts that exceed avoided costs, and other discrete issues raised by the commenters.

²⁶¹ NPPC *et al.* Reply Comments at 46 (citing Postal Service Comments at 147); Pitney Bowes Reply Comments at 7.

2. Workshare Discounts that are Below Avoided Costs

Multiple participants suggest adjustments to the lower limit on percentage passthroughs initially proposed in Order No. 4258 (75 percent for Periodicals and 85 percent for all other classes), referred to by commenters as the passthrough floor.

No passthrough floor. The Postal Service opposes setting a passthrough floor.²⁶² The Postal Service maintains that setting a floor is contrary to the language, structure, and objectives of 39 U.S.C. § 3622. Postal Service Reply Comments at 108 n.285. The Postal Service asserts that deepening the workshare discount for mailers who already perform the worksharing activity at the lower rate simply confers rents upon those mailers at the expense of either the Postal Service (counter to Objectives 5 and 8) or non-worksharing mailers that will receive a countervailing rate increase (counter to Objectives 1 and 8). *Id.* at 109. It asserts that deepening workshare discounts immediately reduces unit revenue. *Id.* The Postal Service states that raising discounts to bring passthroughs closer to 100 percent of avoided costs contradicts Objectives 1 and 5. *Id.* at 110. As an example, the Postal Service observes that the cost of a mailer to presort may be less than the cost of physical sorting performed by the Postal Service. *Id.* The remaining commenters on this topic generally support setting a passthrough floor and suggest either lowering or raising the level initially proposed in Order No. 4258.

Lower passthrough floor. GCA suggests that the Commission modify the passthrough floor, allowing for greater tolerance of workshare discounts that do not exceed the cost avoided by the Postal Service. GCA Comments at 24. GCA recommends lowering the passthrough floor to 65 percent for Periodicals (instead of 75 percent, as proposed in Order No. 4258) and to 75 percent for all other classes (instead of 85 percent, as proposed in Order No. 4258). *Id.* at 26. In support of its

²⁶² Postal Service Reply Comments at 111; Postal Service Comments at 146-147.

recommendation to allow greater tolerance of passthroughs below 100 percent, GCA observes that the Commission's analysis exhibits the recent tendency for passthroughs to fall below the proposed lower limit of the applicable band.²⁶³ Also, GCA observes that a mailer may continue worksharing activities, notwithstanding a workshare discount that is less than the cost avoided by the Postal Service, because the mailer would continue to receive returns on the worksharing behavior. GCA Comments at 25.

While reiterating its primary argument that no passthrough floor should be imposed, in the alternative, the Postal Service endorses GCA's suggestion.²⁶⁴ It states that increasing a passthrough below 100 percent might have little impact on worksharing participation and that the main effect of increasing a passthrough below 100 percent might be to reduce the revenue collected from the worksharing mailer (or mail service provider), which would be a windfall. *Id.* at 110. The Postal Service states that under a price cap regime, this would lower the Postal Service's revenue or shift that revenue burden to other rate categories. *Id.*

Valpak supports imposing a passthrough floor to counter the temptation of the Postal Service to set workshare discounts that result in even lower passthroughs and favors setting the level at either 75 percent (as suggested by GCA) or 85 percent (as proposed in Order No. 4258).²⁶⁵

Higher passthrough floor. ABA, MH and NAAD, NPPC *et al.*, and Pitney Bowes support raising the passthrough floor to 95 percent for all classes of mail other than

²⁶³ *Id.* at 24 (citing Order No. 4258 at 94).

²⁶⁴ Postal Service Reply Comments at 110. The Postal Service states that using current prices (those set in Docket No. R2018-1, effective January 21, 2018) and FY 2017 cost avoidances, 45 passthroughs are below the floor proposed in Order No. 4258 (75 percent for Periodicals and 85 percent for all other classes) and 35 passthroughs are below the floor suggested by GCA (65 percent for Periodicals and 75 percent for all other classes). *Id.* at 111 n.291.

²⁶⁵ Valpak Comments at 18; Valpak Reply Comments at 22-23.

Periodicals (instead of 85 percent, as proposed in Order No. 4258).²⁶⁶ In support of its suggestion, ABA states that efficient workshare discounts that reflect the full amount of their avoided costs lower the prices for the worksharing mailers. ABA Comments at 13. MH and NAAD recommend increasing low passthroughs for all mail “by one or two percentage points every year.” MH/NAAD Comments at 10. NPPC *et al.* agree that “workshare discounts set substantially below avoided costs may cause the Postal Service to maintain a larger network or retain more processing operations than necessary.”²⁶⁷ Pitney Bowes asserts that the Commission correctly determined that establishing a passthrough floor on workshare discounts “is required to achieve the statutory purpose of Objective 1 and Factors 5, 7, and 12.” Pitney Bowes Comments at 7.

ANM *et al.* support increasing the passthrough floor for Periodicals more quickly. ANM *et al.* Comments at 97. ANM *et al.* contend that aligning the workshare discounts that are below avoided costs would result in significant savings to the Postal Service without requiring any additional capital expenditures.²⁶⁸

3. Workshare Discounts that Exceed Avoided Costs

Multiple commenters discuss their views of how the initial approach would interact with the exceptions appearing in 39 U.S.C. § 3622(e) and suggest adjustments to the upper limit on percentage passthroughs initially proposed in Order No. 4258 (125 percent for Periodicals and 115 percent for all other classes), referred to as the passthrough ceiling.

²⁶⁶ ABA Comments at 12; MH/NAAD Comments at 10; NPPC *et al.* Comments at 42-43; Pitney Bowes Comments at 11-13.

²⁶⁷ NPPC *et al.* Comments at 43 (citing Order No. 4257 at 216).

²⁶⁸ ANM *et al.* Reply Comments at 46; ANM *et al.* Comments at 94-97.

Statutory exceptions related to excessive workshare discounts. GCA takes the view that the proposed rules would supersede the exceptions to excessive workshare discounts described in 39 U.S.C. § 3622(e). GCA Comments at 20-21. By contrast, the Postal Service asks the Commission to state that the provisions appearing in 39 U.S.C. § 3622(e)(2) and (3) would continue to serve as exceptions to the applicable band on a case-by-case basis. Postal Service Comments at 147. Valpak supports the Postal Service's request. Valpak Reply Comments at 19.

ANM *et al.* assert that the proposed rules must continue to honor the exceptions appearing in 39 U.S.C. § 3622(e).²⁶⁹ NPPC *et al.* seek clarification on the interaction between the proposed rules and the exceptions appearing in 39 U.S.C. § 3622(e). NPPC *et al.* Reply Comments at 45. NPPC *et al.* interpret the proposed rules as allowing the exceptions appearing in 39 U.S.C. § 3622(e) to apply for passthroughs above the applicable band.²⁷⁰

Lower passthrough ceiling. ABA, MH and NAAD, NPPC *et al.*, and Pitney Bowes support lowering the passthrough ceiling to 105 percent for all classes of mail other than Periodicals (instead of 115 percent, as proposed in Order No. 4258).²⁷¹

ABA suggests that a lower excessive passthrough ceiling would “maximize” incentives to reduce costs and improve efficiency as required by Objective 1. ABA Comments at 12. NPPC *et al.* state that a lower excessive passthrough ceiling would be more efficient and send more cost-effective pricing signals. NPPC *et al.* Comments

²⁶⁹ ANM *et al.* Comments at 12 n.2; ANM *et al.* Reply Comments at 73.

²⁷⁰ NPPC *et al.* Reply Comments at 45; NPPC *et al.* Comments at 6 n.8, 45.

²⁷¹ ABA Comments at 12; MH/NAAD Comments at 10; NPPC *et al.* Comments at 42-43; Pitney Bowes Comments at 11-13. These four commenters appear to focus their remarks on First-Class Mail and USPS Marketing Mail, which would be subject to the proposed range of 85 percent to 115 percent appearing in proposed § 3010.261(c). NPPC *et al.* observe that if the Commission is persuaded that it lacks the legal authority to presume that passthroughs over 100 percent are lawful, the appropriate range should be 95 percent to 100 percent. NPPC *et al.* Comments at 42.

at 43. MH and NAAD recommend decreasing excessive passthroughs for all mail “by one or two percentage points every year.” MH/NAAD Comments at 10. Pitney Bowes contends that setting the passthrough ceiling at 115 percent, as proposed in Order No. 4258, does not “*maximize incentives or use workshare discounts to the fullest extent possible*” to reduce costs and increase efficiency.²⁷² Pitney Bowes asserts that lowering the passthrough ceiling is required by Objective 1, would move workshare discounts closer to ECP, and would mitigate concerns regarding excessive passthroughs. Pitney Bowes Comments at 11.

In addition to supporting a passthrough ceiling of 105 percent for all classes of mail other than Periodicals, GCA also suggests lowering the passthrough ceiling to 115 percent for Periodicals (instead of 125 percent, as proposed in Order No. 4258). GCA Comments at 26. It contends that limiting excessive discounts and lowering the passthrough ceiling is more feasible because “there is much less uncertainty” about the effect of discounts that exceed avoided costs. *Id.* In addition, it asserts that workshare discounts greater than avoided costs unnecessarily deprive the Postal Service of revenue. *Id.* at 24. It further asserts that lowering the tolerance for workshare discounts that exceed avoided costs is especially necessary given the Postal Service’s finances. *Id.* at 25-26.

The Postal Service opposes lowering the passthrough ceiling for many of the same reasons it cited in relation to increasing the passthrough floor, such as concern that a small absolute change in unit cost could significantly affect a passthrough, difficult administration, and sub-optimal pricing. Postal Service Reply Comments at 107-108. The Postal Service asserts that lowering the passthrough ceiling would be contrary to 39 U.S.C. § 3622(e)(3). *Id.* at 108. The Postal Service reiterates that lowering the

²⁷² Pitney Bowes Comments at 10-11 (emphasis in original). Pitney Bowes derives this standard from Order No. 3673. *Id.* at 10 (citing Order No. 3673 at 4).

passthrough ceiling can severely constrain pricing flexibility (Objective 4) and that convergence on a single price point would abolish it altogether.²⁷³

Higher passthrough ceiling. Valpak suggests raising the passthrough ceiling for all classes of mail other than Periodicals to 125 percent. Valpak Comments at 18; Valpak Reply Comments at 23. It reasons that this would minimize the rate shock for sectional center facility-entered letters. Valpak Comments at 18. It also asserts that this would be prudent given the continued use of outdated assumptions in the cost avoidance methodology. Valpak Reply Comments at 21. Acknowledging that the Postal Service has already begun to reduce excessive workshare discounts incrementally, Valpak urges the Commission to allow this process to continue in a measured manner. Valpak Comments at 18.

4. Other Issues

Multiple commenters raise other specific issues, which are summarized by topic below.

De minimis exception. The Postal Service requests a *de minimis* exception to allow variation of workshare discounts by plus or minus \$0.001 in an effort to promote “pricing flexibility and allow[] for normal variability in passthrough ratios.” Postal Service Comments at 147. Valpak supports the Postal Service’s request. Valpak Reply Comments at 19. NPPC *et al.* disagree that there is a need for such an exception. NPPC *et al.* Reply Comments at 46.

Calculation of multi-tiered workshare discount categories. GCA requests to change how workshare discounts in a multi-tiered category are calculated. GCA Comments at 22-24. GCA posits that using the existing approach to calculate

²⁷³ *Id.*; Postal Service Comments at 147.

workshare discounts, based on the presort tree, may result in some of the percentage passthroughs falling outside the applicable band. *Id.* at 22.

In direct response to the question posed by GCA regarding the calculation of discounts in a multi-tiered category, NPPC *et al.* suggest that the correct marginal passthrough would be 100 percent, regardless of how the benchmark was set. NPPC *et al.* Reply Comments at 45-46. NPPC *et al.* add that adopting their narrower proposed band of 95 percent to 105 percent would address GCA's concern. *Id.* at 46. Pitney Bowes recommends that the Commission dismiss GCA's suggestion. Pitney Bowes Reply Comments at 7. Pitney Bowes states that GCA's suggestion is an unnecessary complication because incremental (not cumulative) passthroughs are the relevant consideration for pricing efficiency. *Id.* Pitney Bowes states that its position is reinforced by Commission precedent recognizing that pricing efficiency focuses on the pricing signal from the benchmark rate category (which is generally the next higher presort tier).²⁷⁴

Additional considerations. RR Donnelley suggests taking into account more accurate cost avoidance analysis, the indirect positive implications in managing postal machine and labor resources, and service performance. RR Donnelley Comments at 1.

Annual compliance review. Finally, with respect to the annual compliance review of workshare discounts, the Postal Service suggests evaluating compliance using the most recent cost avoidance estimates available at the time of the most recent price adjustment filing, rather than using any subsequent cost avoidance estimates that might be available at the time of the ACR. See Postal Service Reply Comments at 111. The Postal Service asserts that it would be too cumbersome and capricious to measure (and

²⁷⁴ *Id.* at 7-8 (citing Order No. 536 at 21).

potentially order changes to) workshare discounts at multiple points in a year. *Id.* at 112.

C. Commission Analysis

1. Overview

In this section, the Commission responds to the comments it received regarding its initial approach. The Commission notes that these comments have contributed to improving the Commission's proposal to regulate workshare discounts. In many respects, the refinements proposed by the Commission in this Order dispense with the concerns underlying the comments.

The initial approach required compliance with symmetrical percentage passthrough bands after a 3-year grace period. Therefore, the comments focus on suggestions to adjust the upper and lower limits of the bands (whether to widen or narrow the range of compliant passthroughs and whether to set the bands in a symmetrical or asymmetrical manner) and to adjust the 3-year grace period (whether to lengthen or dispense with the grace period). The Commission has taken into account the comments suggesting stricter adherence to ECP as soon as possible, along with the comments expressing a need for flexibility to deviate from ECP. The Commission acknowledges the concerns regarding the Postal Service's ability to comply with the new rules without some transitional flexibility and the countervailing concern that workshare discounts should not be allowed to stagnate for 3 years and that improvement should begin immediately. The Commission finds that it must balance these differing views.

Based on the comments and consistent with the PAEA, the Commission revises its approach to separately address workshare discounts that are below avoided costs and workshare discounts that exceed avoided costs. Thus, comments directly related to the initially proposed workshare discount passthrough bands are no longer

applicable. The focus of the revised approach is to encourage incremental improvement in pricing efficiency rather than an imposed categorical time limit for compliance. Rather than impose a 3-year time limit for each workshare discount to comply with the Commission's approach, the revised approach instead would codify limited circumstances in which the Postal Service may propose to set a workshare discount below or above its avoided costs. To address the finding that the Postal Service had the ability to set workshare discounts in accordance with ECP, yet failed to do so, Order No. 4258 focused upon an initial approach that would promote workshare discounts that adhere to ECP. The Commission continues to find that a determination of whether workshare discounts are consistent with the objectives of the PAEA begins with ECP. In its revised approach, the Commission proposes to codify the "do no harm" principle to prohibit the Postal Service from making workshare discounts more inefficient.

Additionally, the Commission acknowledges that multiple commenters express the view that the Commission should aim to incentivize productive efficiency for the postal sector. The revised approach intends to encourage the production, processing, and delivery of mail at the lowest combined cost for the postal sector (combining the cost for the mailer, the Postal Service, and any additional producer or processor) through its focus on ECP. Enabling the production, processing, and delivery of mail at the lowest combined cost requires full ECP rates, *i.e.*, workshare discounts that are equal to the costs avoided by the Postal Service for not providing the applicable service, resulting in a passthrough of 100 percent. The revised approach aims to adhere as closely to ECP principles as practicable and therefore achieves the pricing and operational efficiency components of Objective 1 (maximize incentives to increase efficiency).

The Postal Service contends that the limitations on workshare discounts are contrary to Objective 2 (predictable and stable rates) and Objective 4 (pricing flexibility).

However, both the initial and revised approaches are consistent with these objectives. Both the initial and revised approaches provide a mechanism for price changes to be incremental in timing and magnitude and for customers to have sufficient advance notice to plan their mailing budgets, consistent with the purpose of Objective 2. See Order No. 4257 at 55-56, 101-103. Furthermore, pricing flexibility as contemplated by Objective 4 consists of multiple dimensions. See *id.* at 144. Both the initial and revised approaches limit only the workshare discount aspect of pricing and do not restrict the setting of the benchmark prices. Additionally, the Commission recognizes the need for any approach to allow some flexibility to deviate from ECP, if adequately justified. Therefore, the revised approach incentivizes the Postal Service to make progress toward ECP by codifying certain quantitative parameters and limited qualitative exceptions specific to workshare discounts that exceed their avoided costs and workshare discounts that are below their avoided costs. This revised approach is a well-balanced method to achieve the objectives in conjunction with each other.

The Commission disagrees with the Postal Service and GCA that no changes to workshare discounts are necessary or permitted. As noted above, in Order No. 4257, the Commission determined that “all aspects of the system of ratemaking and classification of market dominant products outlined in section 3622, including workshare discounts, [were] appropriately incorporated” as part of its 10-year review. Order No. 4257 at 2, 12. Accordingly, in that review the Commission determined that, because most workshare discounts during the PAEA era had been set substantially above or below their avoided costs, the Postal Service failed to set workshare discounts as intended by the PAEA. *Id.* at 136-138, 145. Both the Commission’s initial approach as proposed in Order No. 4258 and its revised approach in the instant Order are intended to address this issue. By addressing the pricing practices that frustrate the achievement of Objective 1, the revised approach better achieves the objectives than the existing ratemaking system.

Below, the Commission separately addresses suggestions specific to workshare discounts that are below avoided costs, suggestions specific to workshare discounts that exceed avoided costs, and other discrete issues raised by the commenters.

2. Workshare Discounts that are Below Avoided Costs

In this Section, the Commission responds to suggestions to abandon, lower, or raise the proposed passthrough floor.

No passthrough floor. With respect to the Postal Service's objections to setting a passthrough floor at all, the Commission has long held that low workshare discounts run counter to the pricing efficiency component of Objective 1.²⁷⁵ Throughout the PAEA era, the Commission has focused its review of workshare discounts on the PAEA's direction that the Commission ensure that discounts do not exceed avoided costs, except as provided under section 3622(e). See, e.g., Order No. 536 at 18. At the same time, the Commission has consistently encouraged the Postal Service to improve workshare discounts that are below avoided costs.²⁷⁶ Existing § 3010.14(b)(5) requires the Postal Service to explain the rationale for proposing workshare discounts that are substantially below avoided costs. The Commission acknowledges that its revised approach would more rigorously enforce adherence to ECP for workshare discounts that are below their avoided costs. This change is necessary to address the Commission's finding that the Postal Service had the ability to adhere to ECP throughout the PAEA era but did not do so. As observed by commenters, fuller

²⁷⁵ See Docket No. ACR2007, *Annual Compliance Determination*, March 27, 2008, at 97 (FY 2007 ACD) (quoting 39 U.S.C. § 3622(b)) ("Although the requirements of the PAEA do not directly address workshare discounts that are below 100 percent of avoidable costs, the first objective in 39 U.S.C. § 3622(b) is '[t]o maximize incentives to reduce costs and increase efficiency.' Passthroughs below 100 percent typically indicate inefficiencies.").

²⁷⁶ See, e.g., FY 2007 ACD at 97 ("The Postal Service should examine such potential inefficiencies and work to set rates which more fully reflect efficient component pricing.").

recognition of avoided costs produces multiple benefits, such as sending more efficient pricing signals to mailers and improving productive efficiency in the postal sector.²⁷⁷

In its objections to a passthrough floor, the Postal Service states that increasing workshare discounts that are presently below their avoided costs may force the Postal Service to choose between harming its finances or increasing the rates of other mailers to a level that is not just and reasonable. See Postal Service Reply Comments at 108-109. The Postal Service fails to provide any explanation of how such harm is likely to occur.

When developing prices for Market Dominant classes, the Postal Service is required to choose from a very large set of possible prices. For example, in the USPS Marketing Mail class, there are more than 400 different prices.²⁷⁸ The Postal Service is not selecting worksharing discounts in isolation, but rather part of a broad set of prices. If the Postal Service increases the size of a workshare discount (e.g., sets a workshare discount that is currently below avoided cost closer to or equal to its avoided cost), this would increase the rate adjustment authority for the applicable class. The Postal Service retains flexibility to determine how to use the resulting increase in rate adjustment authority (as well as the other sources of rate adjustment authority for that class). The Postal Service may do any (or all) of the following: increase rates for the affected mailpieces (e.g., raise the benchmark rate), increase rates elsewhere in that class in that rate proceeding (e.g., raise a different rate cell(s)), and/or decline to use all or part of that rate adjustment authority in that rate proceeding (e.g., “bank” all or part of that rate adjustment authority for future use). Although this may increase rates for some

²⁷⁷ See ABA Comments at 12 (quoting Order No. 4258 at 89); see also ANM *et al.* Comments at 56 n.34.

²⁷⁸ Mail Classification Schedule § 1200, January 27, 2019 (with revisions through September 30, 2019), available at: <https://www.prc.gov/mail-classification-schedule>.

mailers, there is no evidence that increasing the size of workshare discounts under 100 percent will cause other rates to reach a level that is not just and reasonable.

The Postal Service also states that a passthrough floor may run counter to allocative efficiency. See *id.* at 109. It contends that if mailers are already performing a workshare activity given a discount that produces a less than 100-percent passthrough, then increasing the discount to bring the passthroughs to 100 percent would be overly beneficial to those mailers at the expense of the Postal Service and other mailers. *Id.* The Commission contends that the economic principles underlying ECP are a better indication of how mailers will be affected by an increase in a discount. This, in turn, will shift the cost of performing the worksharing activity from the Postal Service to the mailer. Establishing workshare discounts at efficient levels sends the correct signal to the marketplace of third party service providers.²⁷⁹ With the correct signals in place, the marketplace can make the necessary adjustments to determine what activities to undertake. As a result of the correct signaling, mailers may also be incentivized to start new or expand existing worksharing activity.

The Postal Service also objects to requirements to raise low workshare discounts on the basis that this would “force the Postal Service to perpetually chase the volume trend.” *Id.* The Postal Service contends that “[a]s volume declines, economies of scale and density are lost, and average unit costs rise. As average unit cost increases, so too does the avoided cost of a workshared activity, meaning that the Postal Service would have to increase the size of the discount in order to maintain the same passthrough rate.” *Id.* The Postal Service asserts that the closer to 100 percent a passthrough is required to be set, “the more difficult and high-maintenance” the task of rate-making becomes. *Id.*

²⁷⁹ A third party servicer (or third party consolidator) is a mail service provider that aggregates mail from one category and converts it to another category for a fee. Order No. 536 at 49.

Essentially, the Postal Service is making two separate arguments. First, it argues that declining volumes necessarily increase cost avoidances. However, the Postal Service does not present any evidence supporting this assertion. While declining volumes can lead to increases in average cost, cost avoidances reflect differences in attributable costs associated with the applicable workshare activity. Volume declines impact attributable costs differently than they impact average costs. The cost segments involved in the calculation of cost avoidances are only a subset of the cost segments involved in the calculation of average costs. And, cost segments vary with volume to different extents. Historically, the kind of precipitous changes in cost avoidances described by the Postal Service have not occurred.²⁸⁰

Second, the Postal Service argues that the Commission should not impose any requirement on discounts with passthroughs below 100 percent in an environment with declining volume because it would have to continually adjust the discounts. The Commission disagrees with the Postal Service that the potential for more frequent changes to workshare discounts should deter the Commission from regulating passthroughs below 100 percent. Regulation always imposes some burden on the regulated entity. That a regulation may increase the difficulty of the Postal Service's rate design process is not, on its own, a reason to defer regulation. In addition, the Postal Service presents no evidence that declining volumes lessen the importance of ECP. The Commission finds that the benefits of more strictly applying ECP principles to workshare discounts outweigh the challenges imposed on the Postal Service's rate-

²⁸⁰ See, e.g., Docket No. ACR2018, Library Reference USPS-FY18-3, December 28, 2018; Docket No. ACR2017, Library Reference USPS-FY17-3, December 29, 2017; Docket No. ACR2016, Library Reference USPS-FY16-3, December 29, 2016; Docket No. ACR2015, Library Reference USPS-FY15-3, December 29, 2015; Docket No. ACR2014, Library Reference USPS-FY14-3, December 29, 2014; Docket No. ACR2013, Library Reference USPS-FY13-3, December 27, 2013; Docket No. ACR2012, Library Reference USPS-FY12-3, December 28, 2012; Docket No. ACR2011, Library Reference USPS-FY11-3, December 29, 2011; Docket No. ACR2010, Library Reference USPS-FY10-3, December 29, 2010; Docket No. ACR2009, Library Reference USPS-FY09-3, December 29, 2009; Docket No. ACR2008, Library Reference USPS-FY08-3, December 29, 2008; Docket No. ACR2007, Library Reference USPS-FY07-3, December 28, 2007.

setting process. The Commission observes that nothing in the PAEA suggests that making reasonable annual adjustments to workshare discounts in either direction is prohibited or undesirable.

For these reasons, the Commission declines to adopt the Postal Service's suggestion to retain the existing rules applicable to workshare discounts that are below avoided costs.

Lower passthrough floor. In the alternative, the Postal Service endorses GCA's suggestion to lower the passthrough floor by 10 percentage points—to 65 percent for Periodicals and 75 percent for all other classes. Postal Service Reply Comments at 110-111. The Commission finds that neither GCA nor the Postal Service have adequately supported the need for the levels suggested. Instead, the suggested levels appear to reflect the general goal to preserve some of the pricing flexibility afforded under the existing rules and provide a counterpoint to other commenters' suggestions to increase the passthrough floor by 10 percentage points. As GCA acknowledges, future rulemakings may be needed to adjust the workshare discount rules. GCA Comments at 26 n.38. The Commission intends to fully review its workshare discount rules after 5 years and may make necessary corrections or improvements prior to that time.²⁸¹

Higher passthrough floor. While ABA, MH and NAAD, NPPC *et al.*, and Pitney Bowes suggest raising the percentage passthrough floor to 95 percent for all classes of mail other than Periodicals, MH and NAAD suggest that the Commission's proposed passthrough floor should only be achieved over a 10-year, gradual period. At this juncture, the Commission is not persuaded that increasing the floor from the initial proposal of 85 percent is necessary or prudent. As explained in Order No. 4258, the 85-percent passthrough appears to be a reasonable target and would promote

²⁸¹ For instance, after promulgating part 3010 and before beginning this review, the Commission engaged in rulemakings to address discrete issues.

considerable improvement. Order No. 4258 at 93-95. Therefore, as part of its revised approach, the Commission continues to set the passthrough floor at 85 percent.

Although the Commission acknowledges that setting a floor of 95 percent would be closer to achieving ECP than a floor of 85 percent; because the passthrough floor would be a new regulatory requirement, it is important to avoid setting the level too high at the outset. The perpetuation of workshare discounts that produce passthroughs below 85 percent represents a particularly inefficient pricing practice, and the Commission determines that it is prudent to focus its new rules on phasing out the most inefficient pricing practices first. Moreover, the Commission will continue to encourage the Postal Service to improve the efficiency of workshare discounts that produce passthroughs between 85 percent and 100 percent. Additionally, under the Commission's revised approach, should a passthrough fall below 85 percent, the workshare discount would still be permissible if the proposed workshare discount is new or if the proposed workshare discount is at least 20 percent higher than the existing workshare discount. If a passthrough is below 85 percent and the Postal Service is unable to increase the workshare discount by at least 20 percent, the Postal Service may file an application in advance of the next rate adjustment proceeding that shows by a preponderance of the evidence that raising the proposed workshare discount by at least 20 percent would impede the Postal Service's operational efficiency.²⁸²

²⁸² Unlike an application for waiver related to an excessive discount, which may be requested on four different bases (discussed below), the basis for a waiver application related to a low workshare discount is limited to operational efficiency only. The Commission considered permitting "rate shock" as a basis for a waiver application related to a low workshare discount but determined that allowing for passthroughs as low as 85 percent and limiting any required adjustment of a low workshare discount to a maximum of 20 percent provides adequate protection against rate shock. Conversely, the Commission permits an operational efficiency waiver for a low workshare discount because it is foreseeable that such a waiver could be necessary. For example, if the Postal Service were required to increase a low dropshipping workshare discount in order to comply with proposed § 3010.284(c) or (e), it may draw more volume to downstream facilities than those facilities have the capacity to handle, negatively impacting the Postal Service's operational efficiency.

In addition, the Commission raises the passthrough floor for Periodicals to 85 percent in its revised approach, as supported by MH and NAAD and ANM *et al.*²⁸³ The Commission initially set a slightly wider symmetrical percentage passthrough compliance band for Periodicals than for the other classes (from 75 percent to 125 percent instead of 85 percent to 115 percent) in order to “take[] into account the wider variance observed in passthroughs for Periodicals and ‘the educational, cultural, scientific, or informational [(ECSI)] value’ of those mailpieces.”²⁸⁴

The revised approach better addresses the Periodicals passthroughs that are below 85 percent by incentivizing the Postal Service to propose a workshare discount that is at least 20 percent higher than the existing workshare discount. The Commission also observes that the ECSI value of the mailpiece will continue to be a factor with respect to justification of workshare discounts that *exceed* their avoided costs but is not relevant for setting the passthrough floor. The revised approach no longer rests upon the need for exact symmetrical treatment of workshare discounts below and above their avoided costs.

3. Workshare Discounts that Exceed Avoided Costs

Section 3622(e) of title 39 codifies exceptions to the general principles of ECP that allow workshare discounts to exceed their avoided costs. The commenters offer differing views of how the initial approach would interact with the exceptions appearing

²⁸³ MH and NAAD support an eventual passthrough floor of 95 percent for “all mail.” See MH/NAAD Comments at 10 (emphasis omitted). ANM *et al.* note that the initial approach permitted a passthrough floor for Periodicals that, even after the proposed grace period, “would still be only 75 percent,” which insinuates a disapproval with that percentage. See ANM *et al.* Comments at 97.

²⁸⁴ Order No. 4258 at 93 (citing 39 U.S.C. § 3622(c)(11) and (e)(2)(C)).

in 39 U.S.C. § 3622(e).²⁸⁵ These commenters have alerted the Commission of the need to clarify this point. As previously stated, the Commission intended for the initial approach to establish quantitative passthrough bands to accommodate the provisions of 39 U.S.C. § 3622(e).²⁸⁶ Because the existing ratemaking system failed to adequately incentivize the Postal Service to set workshare discounts in accordance with ECP but allowed pricing flexibility and created predictability and stability, the initial approach circumscribed the operation of the exceptions appearing in 39 U.S.C. § 3622(e) through the proposed quantitative passthrough bands. Although the passthrough bands reduced the likelihood that an exception would be necessary, they did not eliminate the possibility that setting a discount within a band could potentially have disruptive effects on the Postal Service and its customers.²⁸⁷ For that reason, the Commission revises its approach to align with the qualitative provisions of 39 U.S.C. § 3622(e), while maintaining the general focus of the approach—remedying the lack of adequate incentives to adhere to ECP by circumscribing the application of the qualitative exceptions that would allow the Postal Service to set an excessive workshare discount.

Similar to its revised approach with respect to workshare discounts below their avoided costs, the Commission proposes revisions that would allow the Postal Service to set a workshare discount above its avoided costs in four limited circumstances. These four circumstances incentivize the Postal Service to set workshare discounts in accordance with ECP and fully align with the safeguards provided by the exceptions

²⁸⁵ ANM *et al.* Comments at 12 n.2; ANM *et al.* Reply Comments at 73; GCA Comments at 20-21; NPPC *et al.* Comments at 6 n.8, 45. NPPC *et al.* Reply Comments at 45; Pitney Bowes Reply Comments at 7-9; Postal Service Comments at 147; Valpak Reply Comments at 19.

²⁸⁶ See Order No. 4258 at 93. Proposed § 3010.123(f) and (g) retains the requirements of existing § 3010.12(b)(5) and (c) pertaining to the schedule of workshare discounts and the contents of a Postal Service's request to review a notice of rate adjustment that establishes a new workshare discount, respectively. See *id.* at 98. Similarly, the regulations appearing in existing § 3050.21(e) that facilitate the Commission's annual determination of compliance with the provisions of 39 U.S.C. § 3622(e) were not affected in Order No. 4258.

²⁸⁷ Potential effects include passthroughs that move further away from 100 percent within the passthrough band, rate shock, or impediments to operational efficiency.

appearing in 39 U.S.C. § 3622(e). First, the revised approach permits a new proposed workshare discount to be set above its avoided costs, consistent with 39 U.S.C. § 3622(e)(2)(A)(i). Second, to promote improvement (and eventual phase out) of workshare discounts that exceed their avoided costs, the revised approach permits a proposed workshare discount to exceed its avoided costs if it is at least 20 percent lower than the existing workshare discount. Third, a proposed workshare discount may exceed its avoided costs if it is justified under 39 U.S.C. § 3622(e)(2)(C) and the Postal Service provides an adequate and transparent rationale. Fourth, if the Postal Service files an application in advance that shows by a preponderance of the evidence that rate shock or operational efficiency concerns limit the Postal Service's ability to lower an excessive workshare discount, would lead to a loss of volume and reduce the aggregate contribution to institutional costs, or result in a further increase in rates paid by mailers not able to take advantage of the discount, then the discount would be allowed. See 39 U.S.C. § 3622(e)(2)(B)-(D) and (e)(3).

The Commission's revised approach addresses the comments advocating for stricter adherence to ECP balanced with the need for *ad hoc* deviation from ECP (provided that such deviation is adequately justified pursuant to 39 U.S.C. § 3622(e)). The Commission's revised approach aligns more closely with 39 U.S.C. § 3622(e), which prohibits passthroughs above 100 percent unless an exception applies, and aligns more closely with ECP principles. Setting the passthrough ceiling at 100 percent is in line with recommendations by ABA, MH and NAAD, NPPC *et al.*, GCA, and Pitney Bowes.

Although Valpak suggests a more permissive compliance band for excessive passthroughs, its underlying concern is the possibility of rate shock. The revised approach fully addresses this concern. Instead of raising the upper limits for excessive passthroughs as Valpak suggested, the revised approach encourages the Postal Service to phase out the excessive workshare discount by 20 percent in each rate

adjustment consistent with 39 U.S.C. § 3622(e)(2)(B)(ii). For rare cases where that 20-percent reduction could lead to rate shock, the revised approach provides a process that allows the Postal Service to seek an advance waiver by supporting its claim of rate shock by a preponderance of the evidence.

The Commission is aware that stricter regulation of workshare discounts limits the Postal Service's pricing flexibility. However, Congress did not intend for the Postal Service to have unrestrained pricing authority for its Market Dominant products, as evidenced by the price cap regime promulgated in 39 U.S.C. § 3622(d) and the restrictions on workshare discounts promulgated in 39 U.S.C. § 3622(e). As noted above, with its revised approach, the Commission aims to strike a balance between maximizing efficiency and unreasonably restricting the Postal Service's pricing decisions. The Commission's revised approach should produce passthroughs more in line with ECP principles than the current rules in place since the PAEA's enactment.

4. Other Issues

Below, the Commission analyzes the *de minimis* exception suggested by the Postal Service, the change to the calculation of multi-tiered workshare discount categories suggested by GCA, the additional considerations suggested by RR Donnelley, and the changes to the annual compliance review of workshare discounts suggested by the Postal Service.

De minimis exception. The Postal Service requests a *de minimis* exception to allow for variation of workshare discounts by plus or minus \$0.001. Postal Service Comments at 147. NPPC *et al.* disagree that there is a need for such exception.²⁸⁸ The Commission also disagrees that such an exception is necessary.

²⁸⁸ NPPC *et al.* Reply Comments at 46 (citing Postal Service Comments at 147).

To respond to this request fully, the following background concerning the calculation of percentage passthroughs is relevant. Passthroughs are calculated by dividing the workshare discount (rounded to the nearest thousandth or \$0.001) by the cost avoided by the Postal Service for not providing the applicable service (using unrounded unit avoided cost) and expressing the result as a percentage (rounded to the nearest tenth). Therefore, in some instances the calculated percentage passthrough might deviate from exactly 100 percent due to the differing rounding conventions even when the Postal Service has set a workshare discount equal to the avoided cost. Revised proposed subpart J properly accounts for such a result by phrasing the limitations on excessive discounts in terms of the Postal Service's plans to set workshare discounts that would exceed the cost avoided (rather than to set a passthrough exceeding 100 percent). It is also notable that 39 U.S.C. § 3622(e) prohibits workshare discounts from exceeding avoided costs except in six situations, none of which involve a *de minimis* exception. Moreover, revised proposed subpart J permits workshare discounts to produce a passthrough from 85 percent to 100 percent, which is more than sufficient to encompass variation of the workshare discounts by plus or minus \$0.001.

Calculation of multi-tiered workshare discount categories. The Commission declines to adopt GCA's suggestion to change how workshare discounts in a multi-tiered category are calculated. GCA does not present justification for why the Commission should depart from precedent concerning how to measure the costs avoided by worksharing.²⁸⁹ Furthermore, changes to accepted analytical principles related to workshare discounts are outside of the scope of this proceeding. Order No. 4258 at 96. Any interested person may file a petition with the Commission to initiate a proceeding to consider changing accepted analytical principles. 39 C.F.R.

²⁸⁹ See GCA Comments at 22-24; Order No. 536 at 20-22; see also Pitney Bowes Reply Comments at 7-8; NPPC *et al.* Reply Comments at 45-46.

§ 3050.11(a). The proponent of the change must identify the accepted analytical principle for review, explain any perceived deficiencies, and suggest remedies. 39 C.F.R. § 3050.11(b).

Additional considerations. RR Donnelley suggests that the Commission take into account additional considerations related to the calculation of the cost avoided by the Postal Service for not providing the applicable service. See RR Donnelley Comments at 1. No specific explanation of how this should be done is provided. In any event, as explained above, the suggestion that the Commission reconsider the accepted methodologies that underlie cost avoidance calculations is outside of the scope of this proceeding. Any interested person may file a petition with the Commission to initiate a proceeding to consider such changes.

Annual compliance review. With respect to the annual compliance review of workshare discounts, the Postal Service fails to adequately justify its suggestion that the Commission depart from its existing practice, which evaluates compliance using the most recent cost avoidance estimates available. See Postal Service Reply Comments at 111-112. Accordingly, the Commission declines to adopt the Postal Service's suggestion to use less recent data for the annual compliance review.

D. Commission Proposal

After consideration of the comments, the Commission refines its initial approach by dispensing with the 3-year grace period. Consistent with the Commission's long-standing practice of starting its analysis of workshare discounts with ECP, the Commission proposes to adopt the "do no harm" principle as the starting point for its revised approach. The revised approach would prohibit workshare discounts that are equal to avoided cost from being changed (that is, set below or above avoided cost). Moreover, the revised approach would prohibit workshare discounts that are below

avoided cost from being reduced and workshare discounts that exceed avoided cost from being increased.

Additionally, the Commission refines its approach to separately address workshare discounts that are below avoided costs and workshare discounts that exceed avoided costs and permits the Postal Service to propose to set a workshare discount below its avoided costs or exceeding its avoided costs only under certain circumstances. A low workshare discount or an excessive workshare discount would be permitted if it were new, if it would represent an improvement of 20 percent over the existing workshare discount, or if it would be set in accordance with a prior Commission order (via a newly proposed waiver process). A low workshare discount would also be permitted if the proposed workshare discount would produce a passthrough of at least 85 percent (referred to interchangeably as the passthrough floor discussed above). Additionally, an excessive workshare discount would be permitted if it would be provided in connection with a subclass of mail, consisting exclusively of mail matter of ECSI value (39 U.S.C. § 3622(e)(2)(C)) and accompanied by certain information to ensure transparency.

Under the revised approach, in each ACD the Commission will determine workshare discount compliance by identifying which workshare discounts during the previous fiscal year resulted in passthroughs that either exceed 100 percent or fall below the 85 percent passthrough floor. The Commission will also identify those workshare discounts that are equal to their avoided costs. During its next rate adjustment proceeding, the Postal Service may not adjust a discount that the Commission identified in the most recent ACD as being equal to its avoided cost. However, the Postal Service may set new discounts without restriction. Additionally, the Postal Service has several options to address any non-compliant workshare discounts as determined by the most recent ACD.

First, the Postal Service may set the non-compliant workshare discount equal to its avoided cost.

Second, the Postal Service may improve the non-compliant workshare discount's adherence to ECP by setting the new discount 20 percent lower (excessive discounts) or 20 percent higher (low discounts) than the previous non-compliant workshare discount.

Third, for workshare discounts that are provided in connection with a subclass of mail consisting exclusively of mail matter of ECSI value (39 U.S.C. § 3622(e)(2)(C)), an excessive discount may be permitted if the Postal Service files additional information as described in proposed § 3010.285(c).

Fourth, the Postal Service may set a workshare discount lower than its avoided cost if it would produce a passthrough of at least 85 percent.

Finally, the Postal Service may request a waiver prior to the next rate adjustment filing that allows the Postal Service to set the discount differently.²⁹⁰ With the waiver process, the Commission's intent is to require the Postal Service to submit the necessary data so that the Commission has the opportunity to analyze why the Postal Service is unable to set the discount consistent with or closer to ECP. Under the existing ratemaking system, the Commission is unable to scrutinize in detail the Postal Service's claims regarding the statutory exceptions of 39 U.S.C. § 3622(e) prior to excessive workshare discounts going into effect due to the short timeframe for review of rate adjustment filings. In its initial approach, the Commission sought to address this by developing percentage passthrough bands to accommodate the exceptions. With its revised approach, the Commission creates a process through which a claimed exception can be thoroughly vetted by the Commission before the Postal Service files

²⁹⁰ As discussed in more detail below, requests for waiver must be filed at least 60 days prior to the Postal Service's next rate adjustment filing.

its next rate adjustment. Additionally, the Commission has consistently encouraged the Postal Service to improve workshare discounts set below avoided costs, and the waiver process will enable the Commission to fully examine why the Postal Service would propose to set a workshare discount substantially below its avoided costs without making a reasonable effort to set that workshare discount closer to ECP.

As an example of its revised approach, the Commission notes that in its FY 2018 ACD, it identified numerous discounts above and below avoided costs. Below, Table VII-1 shows the workshare discount, the avoided cost associated with the discount, and the passthrough percentage for two First-Class Mail worksharing categories.

**Table VII-1
FY 2018 ACD Workshare Discount Examples
First-Class Mail**

FY 2018 ACD				Rate Case	
Presorting	Discount	Avoided Cost	Passthrough	Minimum Allowable Discount	Passthrough
First-Class Mail Qualified Business Reply Mail (QBRM)	\$0.015	\$0.018	83.3%	\$0.016	88.9%
First-Class Mail Automation Mixed automated area distribution center (AADC) Letters	\$0.046	\$0.067	68.7%	\$0.055	82.1%

Source: Docket No. ACR2018, Library Reference PRC-LR-ACR2018-3, April 12, 2019, Excel file "2018 FCM Results.xlsx."

The First-Class Mail QBRM passthrough was below 85 percent. Under the Commission's revised approach, in its next rate adjustment filing, the Postal Service would need to increase the discount unless the Commission granted a waiver. Should the Postal Service not request a waiver, it would be required to increase the workshare discount by 20 percent or produce a passthrough of at least 85 percent. Increasing the discount by 20 percent would result in a workshare discount of \$0.018 ($0.015 \times 1.2 = 0.018$) and produce a passthrough of 100 percent. Alternatively, the Postal Service

could set the discount as low as \$0.016, which represents an increase in the workshare discount of only 6.7 percent, yet it would meet the 85-percent passthrough floor threshold. Therefore, under this scenario, the Postal Service could set this workshare discount in the range from \$0.016 to \$0.018 without a waiver.

The First-Class Mail Automation Mixed AADC Letters passthrough was also below the 85-percent passthrough floor, and by a larger margin than First-Class Mail QBRM. Should the Postal Service not request a waiver, it would have to increase the workshare discount by 20 percent or produce a passthrough that is at least 85 percent. In this scenario, the Postal Service may increase the workshare discount from \$0.046 to \$0.055 (or 20 percent) resulting in a compliant workshare discount, despite a resulting passthrough of 82.1 percent. Therefore, under this scenario, the Postal Service could set this workshare discount in the range from \$0.055 to \$0.067 without a waiver.

Below, Table VII-2 shows the workshare discount, the avoided cost associated with the discount, and the passthrough percentage for two USPS Marketing Mail worksharing categories.

Table VII-2
FY 2018 ACD Workshare Discount Examples
USPS Marketing Mail

FY 2018 ACD				Rate Case	
Presorting	Discount	Avoided Cost	Passthrough	Minimum Allowable Discount	Passthrough
Marketing Mail Commercial & Nonprofit Carrier Route destination network distribution center (DNDC) Letters	\$0.027	\$0.019	142.1%	\$0.022	115.8%
Marketing Mail Commercial & Nonprofit High Density and Saturation DNDC Letters	\$0.022	\$0.019	115.8%	\$0.019	100.0%

Source: Docket No. ACR2018, Library Reference PRC-LR-ACR2018-4, April 12, 2019, Excel file "FY18 USPS MM Workshare PRC.xlsx."

The percentage passthroughs for both USPS Marketing Mail worksharing categories exceeded 100 percent. Under the Commission's revised approach, both workshare discounts would have to be adjusted (decreased) unless the Postal Service requested and was granted a waiver.

For USPS Marketing Mail Carrier Route DNDC Letters, without a waiver the Postal Service would be required to decrease the workshare discount from \$0.027 to \$0.022 (or 20 percent), resulting in a passthrough of 115.8 percent. For USPS Marketing Mail High Density and Saturation DNDC Letters, without a waiver the Postal Service would be required to decrease the workshare discount by 14 percent, resulting in a passthrough of 100 percent.

These four scenarios illustrate that the revised approach represents an improvement in incentivizing adherence to ECP compared to the initial approach, which would have accorded the Postal Service 3 years to produce a passthrough between 85 percent and 115 percent. To accommodate the rare situations in which the Postal Service cannot make the kinds of adjustments illustrated above, it may file an application for waiver.

The revised approach requires that the Postal Service file any waiver application at least 60 days prior to its next rate adjustment filing. However, in order to provide the Commission with sufficient time to analyze the application, the Commission encourages the Postal Service to file its request more than 60 days prior to its next rate adjustment filing based on each application's complexity. Additionally, the revised approach provides interested persons with an opportunity to comment on the waiver application. The Commission will issue an order announcing whether the requested waiver will be granted or denied no later than 21 days following the close of any comment period(s). The Commission intends to adhere to this timing to provide the Postal Service with enough advance notice to make adjustments to workshare discounts, if necessary, in its next rate adjustment filing.

VIII. COST REDUCTION REPORTING REQUIREMENTS

A. Introduction

Consistent with Order Nos. 4257 and 4258 and in response to commenter suggestions, the Commission proposes to add reporting requirements specifically designed to facilitate tracking costs and monitoring the Postal Service's efforts to reduce costs. See Order No. 4257; Order No. 4258. These reporting requirements are consistent with Objective 1 (maximizing incentives to reduce costs and increase efficiency), Objective 5 (assuring adequate revenues to maintain financial stability), and Objective 6 (reducing the administrative burden and increasing the transparency of the ratemaking process). See 39 U.S.C. § 3622(b)(1), (5), (6).

In Order No. 4257, the Commission found that the Postal Service's costs were reduced during the PAEA era. Order No. 4257 at 191. However, the Commission also found that the Postal Service's cost reductions were not maximized because they were not sufficient to achieve overall financial stability. *Id.* at 222, 225. Moreover, the Commission found that the Postal Service's costs decreased less during the PAEA era than during the 10 years preceding the PAEA era. *Id.* at 224-225. The Commission also determined that cost savings estimates from some of the Postal Service's cost savings initiatives "[were] likely overstated," and that the Postal Service could improve its quantitative measurement of the results of cost savings initiatives. *Id.* at 200.

In its initial approach set out in Order No. 4258, the Commission addressed cost reductions through its evaluation of the Postal Service's position within the financial health cycle. See Order No. 4258 at 35-36, 39-40, 46-53. The Commission took as a starting point its conclusion that the Postal Service is not financially stable because the current ratemaking system has not assured the Postal Service adequate revenues. *Id.* at 33. The Commission noted that adequate revenues are necessary to achieve net income, which over time should lead to retained earnings, which can then be used to fund capital investments that improve operational efficiency. *Id.* at 35-36. The

Commission found that “improvements in medium- and long-term financial stability and increased operational efficiency should lead to cost reductions when the [financial health] cycle is functioning normally[.]” and the Commission accordingly stated its “expect[ation] that its proposal [would] incentivize the Postal Service to take necessary steps to reduce costs.” *Id.* at 36.

In this section, the Commission first summarizes comments received related to cost reductions and provides its analysis of the comments. The Commission then describes its proposed reporting requirements related to cost reductions.

B. Comments

Overview. The Commission received comments pertaining to the Postal Service’s cost reduction efforts and the transparency of those efforts. In particular, commenters express concern about the strength of the incentives for the Postal Service to reduce its costs under the changes to the ratemaking system the Commission has proposed; the impact of the Commission’s proposal on mailers; the role of cost reductions in the Postal Service’s financial health cycle; and the transparency and accountability associated with past cost reduction initiatives, as well as with future cost reduction initiatives and capital expenditures.

Incentives to reduce costs. Many commenters express the view that the current ratemaking system, based on the CPI-U price cap, incentivizes the Postal Service to reduce costs and increase efficiency, and these incentives would be reduced or eliminated if the proposed rules are adopted.²⁹¹ Commenters with this view tend to object to the Postal Service being given increased rate authority with “no strings attached,” *i.e.*, without any mechanism to compel or incentivize further cost reductions or efficiency improvements.²⁹² NPPC *et al.* propose that any additional rate authority above CPI-U be conditioned on reductions in controllable costs or productivity improvements by the Postal Service. NPPC *et al.* Comments at 15-16, 70-71. NPPC *et al.* assert that “the Postal Service is unwilling or unable to reduce its costs, notwithstanding its frequent claim that falling volumes and contribution per delivery point give it ample incentive to do so.” *Id.* at 27 (footnote omitted). NPPC *et al.* further state

²⁹¹ Comments Received from A.B. Data, Ltd., March 1, 2018, at 2; ACI Comments at 4; Comments of the American Catalog Mailers Association, Inc. (ACMA), March 1, 2018, at 3-4 (ACMA Comments); ANM *et al.* Comments at 36-37; Comments of Baldwin Publishing, March 14, 2018, at 2; Comments Received from Business Extension Bureau (BEB), February 28, 2018, at 2; Comments Received from the Calmark Group, March 1, 2018, at 2; Comments of Citizens Against Government Waste, March 1, 2018, at 1-2; Comments of Creative Character, Inc., February 27, 2018, at 2; Comments Received from Direct Marketplace, March 8, 2018, at 2; DMA Comments at 3; Comments of Dow Jones & Company, Inc., February 28, 2018, at 2; Comments Received from Eye/Comm Inc., March 5, 2018, at 2; Comments of Fenske Media Corporation, February 27, 2018, at 2; Comments of Gabriel Group, February 27, 2018, at 2; GCA Comments at 31; Comments Received from Harte Hanks Direct Marketing, March 5, 2018, at 2; Comments Received from Kingery Printing, March 8, 2018, at 2; Comments from LSC Communications, March 1, 2018, at 2-3 (LSC Comments); Comments Received from Main Street Media of Tennessee, March 5, 2018, at 2; Comments Received from Master Graphics, LLC, February 28, 2018, at 2; Comments of Meredith Corporation, February 28, 2018, at 2 (Meredith Corporation Comments); NPPC *et al.* Comments at 7, 9-10, 11-16, 53; Comments of Paulsen Printing, March 26, 2018, at 2; Quad/Graphics Comments at 1; Comments Received from Royal Alliances, (filed March 2 and 12, 2018), at 2; SIIA Comments at 8; Comments of Schreur Printing & Mailing, February 28, 2018, at 2; Comments Received from TEN: Publishing Media, LLC, March 5, 2018, at 2; Comments Received from Thrift-Remsen Printers, March 5, 2018, at 2; Comments Received from Trend Offset Printing, February 27, 2018, at 2; Comments Received from Tribune Direct Marketing, February 28, 2018, at 2; Comments of Wells Printing Company, March 29, 2018, at 2; Comments of Wilen Direct, February 27, 2018, at 2; ANM *et al.* Reply Comments at 47-48.

²⁹² See, *e.g.*, AMA Comments at 5; ANM *et al.* Comments at 36-37; NMA Comments at 9-10; Valpak Comments at 11; GCA Reply Comments at 6.

that “no commenter has shown any causal link between the current price cap system and the Postal Service’s failure to react to the incentives established by that system.” *Id.* at 30.

The Postal Service, on the other hand, argues that it possesses an inherent incentive to maximize cost reduction and efficiency improvement opportunities so as not to have to resort to price increases.²⁹³ The Postal Service maintains that the difficulties it faces with regard to reducing costs and improving efficiency are not caused by insufficient incentives, but rather by insufficient opportunities under existing law. Postal Service Reply Comments at 36. While the Postal Service acknowledges that “[t]he fundamental purpose of price-cap regulation is to encourage efficiency...,” the Postal Service nevertheless maintains that “[n]o form of rate regulation is designed to drive a firm to the precipice of insolvency.” *Id.* at 34. According to the Postal Service, “the core regulatory bargain inherent in any rate-regulation system [is that] rates should be compensatory but not excessive,” which the PAEA recognized by balancing Objective 1 (maximizing incentives to reduce costs and increase efficiency) with Objective 5 (maintaining financial stability) and Objective 8 (maintaining just and reasonable rates).²⁹⁴

Declarants Kwoka and Wilson on behalf of the Public Representative note that “[p]rice caps are intended to motivate the firm to lower costs through operating efficiencies, but the same incentives can cause the firm to reduce costs by lowering service quality.” Kwoka/Wilson Declaration at 9.

Impact on mailers and mail volume. Many commenters maintain that the Commission’s proposal would absolve the Postal Service of the need to manage its

²⁹³ Postal Service Comments at 26; Postal Service Reply Comments at 114.

²⁹⁴ *Id.*; see 39 U.S.C. § 3622(b)(1), (5), (8).

costs by simply permitting it to increase prices, thereby placing the burden of price increases and further cost reduction on mailers.²⁹⁵ These commenters express the view that while mailers have made significant investments in order to facilitate increased automation and worksharing, the Postal Service has done little to reduce its own costs. As stated by one commenter, “[t]here must be a fundamental change in the Postal Service’s culture on costs and operating efficiency...before postal consumers are asked to pay significantly more.”²⁹⁶ In addition, several commenters express concern that if the Postal Service increases its prices rather than cutting its costs or increasing its operational efficiency, then any additional revenue that the Postal Service is able to realize will be offset by corresponding volume declines.²⁹⁷

The financial health cycle. Several comments address the analysis of the Postal Service’s position within the financial health cycle. See Order No. 4258 at 35-36, 39-40, 46-53. As it pertains to cost reductions, the financial health cycle generally requires adequate revenues to fund capital investments that improve operational efficiency and ultimately should lead to cost reductions. See *id.* at 33, 36-37. ABA argues that cost reductions and efficiency improvements should precede any additional revenue, asserting that “[w]ithout cost reductions and efficiency improvements, additional revenue alone will only give the appearance of stabilizing the system.” ABA Comments at 10. ANM *et al.* fault the Commission’s proposal for failing to specify what level of cost reductions or operational efficiency gains must be achieved. ANM *et al.* Comments at

²⁹⁵ Comments Received from the Advertisers Printing Co., Inc., March 5, 2018, at 2; Comments of Bed Bath & Beyond, March 9, 2018, at 1; Comments of Buzz Franchise Brands, March 1, 2018, at 1; Comments of Capital Adhesives & Packaging Corp., February 27, 2018, at 1; Comments Received from Combined Resources, March 5, 2018, at 1; Comments of Eastern Marketing Services, February 28, 2018, at 1; Comments of Freedom Graphic Systems, Inc., March 1, 2018, at 2; Comments of Genesee Valley Publications, February 28, 2018, at 1; Comments of IWCO Direct, February 26, 2018, at 2; LSC Comments at 2; Comments Received from Mystic Logistics, Inc., March 8, 2018, at 1; TCS Comments at 1; Elks Magazine Comments at 2; Comments of the Hartford, March 1, 2018, at 1.

²⁹⁶ Comments of the Consumer Postal Council, March 1, 2018, at 2.

²⁹⁷ ANM *et al.* Comments at 81; Comments of the Envelope Manufacturers Association, March 1, 2018, Attachment at 11; Comments of Taxpayer’s Protection Alliance, March 1, 2018, at 1.

78-79. NPPC *et al.* express “concern[] about the lack of focus on how much money the Postal Service truly needs to operate..., the [Postal] Service’s disinterest in or dismissal of any serious cost reductions or efficiency improvements, and the seeming absence of any plan to manage capital thoughtfully.” NPPC *et al.* Reply Comments at 2. They assert that the Commission “should require the Postal Service to submit a real plan that explains the actual, concrete steps that it will take to reduce its costs...” *Id.* at 32.

The Postal Service asserts that it “has been aggressive in pursuing opportunities to achieve cost reductions and efficiency gains, and will continue to do so, [but] the opportunities for further cost savings come nowhere close to filling the net-income gap that [the proposed rules] would leave open.”²⁹⁸ The Postal Service maintains that any ratemaking system must “be designed to ensure that the Postal Service has a meaningful opportunity to achieve stability so long as it is taking appropriate steps to manage its business responsibly.” Postal Service Comments at 79.

Effectiveness of past cost reduction efforts. Several commenters are critical of the Postal Service’s past cost reduction and efficiency improvement efforts.²⁹⁹ NPPC *et al.* assert that while real unit attributable costs for Market Dominant mail have declined 16 percent over the course of the PAEA era, these reductions were confined to mail processing; not to transportation, delivery, or other costs. NPPC *et al.* Comments at 11-12. Moreover, NPPC *et al.* maintain that the cost declines that did occur were driven more by mailer decisions (*i.e.*, shifting mail to less costly mail classes and products, shifting mail volume away from flats, and making greater use of worksharing), than by cost savings and efficiency improvements on the Postal Service’s part. *Id.* at 12. SIIA notes that the Postal Service has made significant investment in cost reduction initiatives, but it asserts that those initiatives have not been successful. SIIA Comments

²⁹⁸ Postal Service Comments at 66; Postal Service Reply Comments at 36.

²⁹⁹ MH/NAAD Comments at 9; NPPC *et al.* Comments at 11-16; Elks Magazine Comments at 1; ANM *et al.* Reply Comments at 41-42, 43.

at 9. In addition, NPPC *et al.* argue that the cost reduction efforts adopted by the Postal Service have failed to achieve the level of cost savings that was projected. NPPC *et al.* Comments at 12.

NMA, on the other hand, maintains that the Postal Service did, in fact, respond to the CPI-U price cap by reducing its costs and becoming more efficient, though it concedes that some initiatives have failed to achieve projected cost reduction levels. NMA Comments at 4-5. Overall, NMA maintains that the Postal Service has cut billions of dollars in costs, mainly through staff reductions as a result of attrition. *Id.* The Public Representative likewise posits that while “[t]he Postal Service, like any business, makes mistakes..., it cannot be fairly accused of doing *nothing* to decrease costs....” PR Comments at 31. In addition, the Public Representative expresses the view that given the “the magnitude, speed, and persistence of the declines in demand for postal services...[,] [t]he Postal Service’s ability to overcome these declines by means of cost cutting, improved productivity, and innovation proved to be far less than what was needed.” PR Reply Comments at 55. NPMHU argues that the Postal Service has already cut labor costs substantially, and there is no basis for arguing that further cuts are appropriate. NPMHU Comments at 7. For its part, the Postal Service points to a study which concluded that the Postal Service has been aggressive in pursuing opportunities to achieve cost reductions.³⁰⁰

Opportunities for cost reductions and efficiency improvements. Multiple commenters discuss opportunities for cost reductions and efficiency improvements. NPPC *et al.*, ANM *et al.*, and Quad/Graphics reject the contention that further cost

³⁰⁰ Postal Service Reply Comments at 66. The study the Postal Service cites was commissioned by the Postal Service and includes an assessment of the Postal Service’s operations and of the scope and magnitude of potential cost savings available to the Postal Service. See 2017 Postal Service Comments, Appendix C, available at: <https://www.prc.gov/docs/99/99556/app%20c%20a-m%20efficiency%20study%20public.pdf> (A&M Study).

reductions by the Postal Service are infeasible.³⁰¹ NPPC *et al.* suggest a variety of changes, including restraining labor costs and shutting down the Flats Sequencing System, which would purportedly result in substantial cost savings. NPPC *et al.* Reply Comments at 27-31. Meredith Corporation similarly suggests operational and pricing changes intended to reduce processing costs for Periodicals. Meredith Corporation Comments at 2. Other commenters suggest more generally that the Postal Service should find ways to reduce its costs, without identifying any specific areas where costs could be reduced.³⁰² NPPC *et al.* suggest that the Commission play a more active role in scrutinizing the Postal Service's cost reduction efforts, either ensuring that the Postal Service's proposals are actually undertaken or requiring the Postal Service to seek prior approval for capital investments funded with additional cap authority above CPI-U. NPPC *et al.* Comments at 17.

The Postal Service argues that there are statutory restraints on its ability to reduce its costs, and it maintains that the commenters have failed to identify any meaningful cost reduction opportunities within the Postal Service's control that would be sufficient to close the net-income gap that currently exists. Postal Service Reply Comments at 4, 33-37. The Postal Service furthermore characterizes the cost reduction proposals identified by commenters as "inaccurate, unreliable, [and/or] ambiguous." Postal Service Reply Comments at 4. The Public Representative and APWU likewise maintain that the cost reduction opportunities identified by commenters would not be enough, in and of themselves, to reverse the Postal Service's financial instability.³⁰³

Capital expenditures. Commenters address both the Postal Service's past capital investment decisions and the Commission's finding in Order No. 4258 that

³⁰¹ NPPC *et al.* Comments at 15-16; Quad/Graphics Comments at 2-3; ANM *et al.* Reply Comments at 46; NPPC *et al.* Reply Comments at 19-20, 27-31.

³⁰² AF&PA Comments at 7; Comments of Tri-Win Direct, February 27, 2018, at 1.

³⁰³ PR Reply Comments at 31-33; APWU Reply Comments at 8.

additional revenue is necessary for the Postal Service to make capital investments to foster efficiency improvements and cost reductions. See Order No. 4258 at 36-37. ANM *et al.* argue that it is misleading to attribute declines in productivity and failures to reduce costs to a lack of capital investment because the Postal Service has not identified any specific capital investment capable of materially reducing its costs that has been cancelled or delayed due to a lack of funds. ANM *et al.* Reply Comments at 39-40. ANM *et al.* argue that capital investments do not require retained earnings on the Postal Service's part, as evidenced by the fact that the Postal Service has continued to make capital investments during the PAEA era despite having no retained earnings. ANM *et al.* Comments at 44. Both NPPC *et al.* and ANM *et al.* suggest that due to volume declines over the last decade, the Postal Service's capital needs are less than they once were.³⁰⁴

The Postal Service, along with APWU and NALC, argues that adequate funds for capital investment are necessary in order to achieve operational efficiency improvements and cost reductions, and the lack of such funds has limited the Postal Service's ability to continue making efficiency gains and cost reductions.³⁰⁵

Transparency and accountability. NPPC *et al.* state that even with the CPI-U price cap in place, there has been a lack of accountability and transparency regarding the Postal Service's failure to realize cost reductions or efficiency improvements. NPPC *et al.* Comments at 14. Specifically, NPPC *et al.* suggest that the Commission's annual compliance review process³⁰⁶ has proven ineffective at forcing cost reductions or efficiency improvements, because "[t]he accountability for results consists of public

³⁰⁴ ANM *et al.* Reply Comments at 40; NPPC *et al.* Reply Comments at 19-20.

³⁰⁵ Postal Service Comments at 24-25; APWU Comments at 11; NALC Comments at 11.

³⁰⁶ See 39 U.S.C. §§ 3652-3653. Every year the Postal Service submits an ACR to the Commission, and the Commission issues an ACD assessing the Postal Service's compliance with the requirements of title 39.

critiques, not enforcement measures to drive compliance.” *Id.* NPPC *et al.* maintain that the Postal Service lacks data to measure the impact or success of its cost reduction initiatives, and the Commission lacks a process for holding the Postal Service accountable by reviewing its capital investments to ensure that they are prudent and achieve the targeted return on investment. NPPC *et al.* Comments at 13-14.

C. Commission Analysis

1. Overview

The Commission’s initial approach in Order No. 4258 addressed the Postal Service’s incentives to reduce its costs in a general manner. As the Commission discussed, capital investments that improve efficiency will generally also lead to cost reductions. Order No. 4258 at 33, 36-37. Nevertheless, the Commission has taken into account the comments emphasizing the importance of cost discipline and suggesting the possibility that, with increased revenue, the pressure on the Postal Service to practice cost discipline might be reduced. The Commission has also taken into account commenters’ concerns with the need for transparency of the Postal Service’s cost reduction efforts. The Commission accordingly refines its initial approach to introduce new reporting requirements directed towards addressing such concerns. This revised approach balances the commenters’ concerns with the Postal Service’s role as the operator to make its own business decisions.

2. The Postal Service’s Incentives to Reduce Costs

The price cap established by the PAEA was meant, in part, to incentivize the Postal Service to reduce its costs and increase its efficiency. The PAEA sought to accomplish this by eliminating statutorily mandated cost of service regulation while

simultaneously permitting the Postal Service to accumulate retained earnings.³⁰⁷ The PAEA indexed allowable price increases to CPI-U, which prevented the Postal Service from passing excess costs to ratepayers in the form of higher prices. *Id.* This was intended to incentivize the Postal Service to minimize its costs and increase its efficiency in order to accumulate retained earnings. *Id.*

In Order No. 4257, the Commission determined that “the Postal Service has not been financially stable during the PAEA era because the Postal Service has not achieved ‘adequate revenues, including retained earnings, to maintain financial stability.’” Order No. 4257 at 178. Accordingly, the Commission initially proposed to provide the Postal Service with additional rate adjustment authority that would allow rate increases to exceed the change in the CPI-U. Order No. 4258 at 39-87. In its revised approach, the Commission continues to propose providing the Postal Service with additional rate adjustment authority, although the nature and amount of that authority has changed. See Sections IV., V., VI., *supra*. The Commission has determined that additional rate adjustment authority is necessary in order to achieve the objectives of the PAEA. See Sections IV., V., VI., *supra*.

However, in its revised approach, the Commission recognizes the concerns of commenters that additional rate adjustment authority could, in theory, weaken the Postal Service’s incentives to reduce its costs consistent with Objective 1. The Commission appreciates the Postal Service’s argument that it possesses inherent incentives to pursue cost reductions. However, as commenters observe, many of the Postal Service’s cost reduction initiatives over the PAEA era have failed to provide a quantifiable impact.³⁰⁸ Therefore, the Commission finds it prudent to require the Postal

³⁰⁷ Order No. 4257 at 32-33; see also S. Rep. 108-318 at 8-9.

³⁰⁸ See, e.g., Docket No. N2012-1, Advisory Opinion on Mail Processing Network Rationalization Service Changes, September 28, 2012, at 92, 111 (concluding that the Postal Service overestimated the potential for transportation cost savings as part of its Network Rationalization initiative).

Service, for the purposes of transparency and the ability of the Commission and other stakeholders to monitor these issues, to begin reporting on changes in costs and the status of cost reduction initiatives.

The price cap and the potential for retained earnings were intended by the PAEA to be the primary incentives for cost reduction, as reflected in Objectives 1 and 5. Under the rules proposed by the Commission in this Order, the price cap will continue to exist, albeit in a modified form. To the extent that any additional rate adjustment authority might weaken the Postal Service's incentives with regard to cost reductions, the reporting requirements are designed to serve as a counterbalance by requiring the Postal Service to focus its efforts on identifying the underlying causes of cost increases and developing concrete plans to reduce costs. A requirement that the Postal Service regularly report on its cost reduction efforts should provide additional impetus for it to pursue continued cost reductions. Such a requirement also works in conjunction with the operational efficiency component of the performance-based rate authority. See Section V., *supra*. The Postal Service must meet a TFP benchmark each year by increasing productivity in order to gain an additional 1 percentage point of performance-based rate authority. See *id.* As the Commission has found previously, "[c]onditioning rate authority on increases in TFP incentivizes the Postal Service to maximize output while minimizing costs...." See Order No. 4258 at 61.

3. The Need for Increased Transparency and Accountability

Currently, the Commission has insight into the Postal Service's costs and cost reduction efforts through a variety of means, including the Postal Service's ACR. In the ACR, the Postal Service files cost data for all of its products after the end of each fiscal year, which provides a general level of transparency. In the Commission's ACD, the Commission determines compliance with the provisions of title 39 and its related regulations, and, in the event of a finding of noncompliance, is required to "take such action as [the Commission] deems appropriate." See 39 U.S.C. § 3653(c). This

provides a level of general accountability. However, the current Commission rules do not require the Postal Service to specifically report on individual cost reduction initiatives or to explain significant changes in costs between years.³⁰⁹ Receiving contemporary information and explanations about cost reduction initiatives and changes in costs would allow the Commission to investigate these issues more consistently as part of the annual compliance review process.³¹⁰ The information gleaned from such inquiries could lead to further investigation in other proceedings, such as rulemakings or public inquiries, to promote transparency and accountability.

In Order No. 4257 the Commission identified past instances in ACR proceedings, nature-of-service dockets, and other reports where the Postal Service did not adequately quantify cost reductions. Order No. 4257 at 201-203. The Commission found that the Postal Service's cost savings estimates are sometimes overstated and

³⁰⁹ The same is true with regard to the other potential sources of information pertaining to costs and cost reductions. For example, the Postal Service's annual Integrated Financial Plan contains a "Capital Plan" that provides general information about how much capital the Postal Service plans to invest in certain cost categories, but these categories are highly aggregated and the Postal Service does not report on the goals or outcomes of those projects. See, e.g., United States Postal Service, Integrated Financial Plan, Fiscal Year 2019, November 20, 2018, at 6-8. The Commission and postal stakeholders have also had insight into certain cost reduction initiatives at times when the Postal Service has planned nationwide service changes. The Postal Service is statutorily required to request an advisory opinion from the Commission for proposed changes in the nature of postal services on a nationwide or substantially nationwide basis. See 39 U.S.C. § 3661(b). These are referred to as "nature-of-service" dockets. These dockets typically provide a wealth of information about the specific initiative at hand; however, after the Commission issues its advisory opinion, the Postal Service does not provide sufficient information to track the outcomes of the initiatives over time. In addition, these proceedings do not occur on a routine basis.

³¹⁰ The Commission has inquired about cost reduction initiatives and changes in costs through information requests during the ACR process, but these inquiries have been made on an ad hoc basis. The Postal Service has not provided consistent reporting on these issues. See, e.g., Docket No. ACR2018, Responses of the United States Postal Service to Questions 1-28 of Chairman's Information Request No. 6, February 8, 2019, questions 6-7; Docket No. ACR2017, Responses of the United States Postal Service to Questions 1-10 of Chairman's Information Request No. 5, January 26, 2018, at 4; Docket No. ACR2014, Responses of the United States Postal Service to Questions 1-2, 5-11, and 13-14 of Chairman's Information Request No. 3, January 30, 2015, question 6; Docket No. ACR2014, Responses of the United States Postal Service to Questions 1-13 of Chairman's Information Request No. 15, April 6, 2015, question 5.

that the Postal Service could improve its quantitative measurement of cost savings initiative estimates. *Id.* at 200. The Commission reiterated that the Postal Service must “do a better job of quantifying the savings from its cost reduction initiatives.”³¹¹

The Commission has recently begun requiring more granular reporting of costs and cost reduction initiatives with respect to flat-shaped mail products.³¹² At this time, the Commission finds it appropriate to require similar reporting for all Market Dominant mail products.

The proposed reporting mechanism, which requires identification and explanation of cost increases, would afford the Postal Service more time to identify and address these issues than it would if it were merely responding reactively to an information request in the course of an ongoing and deadline-driven proceeding. The proposed reporting requirements would also afford the Commission the ability to conduct a more meaningful review of cost reduction issues because they would enable the Commission to regularly and consistently track the Postal Service’s cost reduction initiatives. In addition, the proposed reporting requirements would provide consistent information that the Commission could use in future years to hold the Postal Service accountable for reducing costs. Moreover, they would provide postal stakeholders the ability to better

³¹¹ *Id.* at 203. Order No. 4257 described the Postal Service’s failures in this regard during the PAEA era. For example, in its advisory opinion with regard to the Retail Access Optimization initiative, the Commission found there was “no effective mechanism to accurately identify cost savings.” Order No. 4257 at 201 (citing Docket No. N2011-1, Advisory Opinion on Retail Access Optimization Initiative, December 23, 2011, at 1-3). In its advisory opinion with regard to the Post Office Structure Plan, the Commission found that the Postal Service lacked an internal review and data collection plan. *Id.* at 202 (citing Docket No. N2012-2, Advisory Opinion on Post Office Structure Plan, August 23, 2012, at 1). In its advisory opinion with regard to the Network Rationalization initiative, the Commission found that the Postal Service likely overestimated associated savings. *Id.* (citing Docket No. N2012-1, Advisory Opinion on Mail Processing Network Rationalization Service Changes, September 28, 2012, at 8). The Commission’s advisory opinion with regard to the Standard Mail Load Leveling initiative found the plan lacked measurements for cost reductions. *Id.* (citing Docket No. N2014-1, Advisory Opinion on Service Changes Associated With Standard Mail Load Leveling, March 26, 2014, at 2).

³¹² See 39 C.F.R. § 3050.50; see also Docket No. RM2018-1, Order Adopting Final Rules on Reporting Requirements Related to Flats, May 8, 2019 (Order No. 5086).

understand and participate in the discussion and evaluation of these issues during the annual compliance review process.

The proposed cost reduction reporting mechanism would improve the comprehensibility and timeliness of information and would support Objective 6's goal of increasing the transparency of the ratemaking process. Any resulting increase in administrative burden on the Postal Service would be minimal, and would be justified in light of improved transparency achieved as a result of reducing information asymmetries.

The revised approach does not, as some commenters advocate, require the Postal Service to seek prior approval before enacting cost reduction efforts or making capital investments. The Commission recognizes that the onus is on the operator (through its management) to identify opportunities to reduce costs and that there are risks involved for the operator in making operational decisions intended to reduce costs and increase efficiency.³¹³ Not every initiative will be successful. Requiring the Postal Service to seek prior approval for cost reduction initiatives would shift the burden from the Postal Service to the regulator. Regulators have imperfect information about the cost reduction opportunities available to a regulated firm.³¹⁴ Therefore, the Commission finds that requiring prior approval could hinder, rather than improve, the efficiency of cost reduction efforts.

³¹³ The Postal Service commissioned a cost efficiency study in 2017 "to determine if operational efficiencies could be made to improve [the Postal Service's] financial situation within its current legislative and regulatory constraints." A&M Study at 1. The study found that "[o]ver 10 years, the estimated savings opportunity under management control would be approximately \$10.5 billion." *Id.* These proposed reporting requirements would allow the Commission and postal stakeholders to monitor the Postal Service's efforts to achieve these and other projected cost savings.

³¹⁴ See Paul L. Joskow, Incentive Regulation in Theory & Practice: Electricity Distribution & Transmission Networks, January 21, 2006, at 3, 5, available at: <https://economics.mit.edu/files/1181>.

D. Commission Proposal

1. Overview

The Commission proposes to codify its revised approach in a newly added § 3050.55, which would require the Postal Service to report on changes in unit costs, specific cost reduction initiatives, and DARs. First, proposed § 3050.55(b) would require annual reporting on the unit costs of Market Dominant products, including additional reporting when unit costs for individual Market Dominant products increase by more than the average unit cost for Market Dominant products collectively between consecutive fiscal years. For such products, the Postal Service would be required to provide more granular cost reporting and a plan to mitigate cost increases in future years. Second, proposed § 3050.55(c) and (d) would require specific reporting on cost reduction initiatives by the Postal Service, as well as ongoing reporting to monitor the impact of such initiatives on performance metrics and unit costs. Third, proposed § 3050.55(e) and (f) would require the provision of summary information regarding ongoing and future projects that have approved Postal Service DARs.

2. Cost Reporting

Proposed § 3050.55(b) would require the Postal Service to annually provide a consolidated cost analysis report that details costs: (1) for Market Dominant products collectively;³¹⁵ (2) for individual Market Dominant products; and (3) for the entire postal system. For individual Market Dominant products, the Commission proposes that the Postal Service provide unit cost data for each product, along with a comparison of that data to the previous fiscal year. In addition, proposed § 3050.55(b) requires a specific

³¹⁵ The Commission excludes Special Services from reporting because of the unique nature of the products in that class, which are not traditional mail products. In addition, for most Special Services, the Postal Service does not report unit cost estimates in its Cost and Revenue Analysis Report. See, e.g., Docket No. ACR2018, Library Reference USPS-FY18-1, December 28, 2018.

analysis evaluating the effect of any mail mix changes on the unit costs.³¹⁶ This information would increase transparency and facilitate the tracking of changes in Market Dominant unit costs. It would also allow the Commission and stakeholders to easily identify Market Dominant products for which costs are increasing faster than average.³¹⁷

When an individual Market Dominant product experiences a percentage change in unit costs that is greater than the overall percentage change for Market Dominant products collectively between consecutive fiscal years, additional reporting would be required. For such products, the proposed rules require that the Postal Service disaggregate the total unit cost for each identified product into the following categories: (1) mail processing unit cost; (2) delivery unit cost; (3) vehicle service driver unit cost; (4) purchased transportation unit cost; (5) window service unit cost; and (6) other unit cost. These categories should sum to the total unit cost for that product. In addition, the Commission proposes that for each such product, the Postal Service provide a narrative that identifies the drivers of changes in unit costs between fiscal years, as well as a plan for each such product to reduce unit attributable costs.

The proposed rules require that the Postal Service provide the percentage change in system-wide total unit costs each year. Total unit costs is the sum of Market Dominant product attributable costs, competitive product attributable costs, and institutional costs, divided by the sum of Market Dominant product volume and competitive product volume. Total unit cost reporting would allow the Commission and

³¹⁶ The analysis requires the Postal Service to use current year costs and FY 2017 volume distributions to demonstrate the impact of mail mix changes. FY 2017 was chosen because it represents the first year of data following the Commission's required review of the ratemaking system pursuant to 39 U.S.C. § 3622(d)(3), which prompted this rulemaking proceeding. See *generally* Order No. 4257. That review began late in CY 2016 and, as a result, FY 2016 was the most recent data available to the Commission at the time the review was conducted. See Order No. 3673.

³¹⁷ The proposed rules limit reporting to nominal cost increases only. For years when the Postal Service is able to decrease the average Market Dominant unit cost, reporting is only required for products that experienced unit cost increases.

postal stakeholders to gain insight into what impact the Postal Service's efforts to reduce overall costs are having.

Much of the data detailed above is already filed by the Postal Service each year as part of its ACR. The reporting requirements proposed in this Order both consolidate the relevant information and provide annual, year-to-year comparisons of the relevant cost data. These consolidated data would provide the Commission and postal stakeholders with more accessible information regarding the Postal Service's efforts to mitigate unit cost increases. In addition, these reporting requirements are designed to compel the Postal Service to, in a systematic way, identify the drivers of changes in costs between fiscal years and produce plans to reduce those costs in future years. Thus, not only are the proposed rules designed to enable the Commission and postal stakeholders to monitor outcomes over time, but they are also intended to provide the Postal Service with additional impetus to analyze its costs and identify areas where they can be decreased.

3. Cost Reduction Initiative Report

Proposed § 3050.55(c) and (d) would require the Postal Service to file specific information regarding planned and active cost reduction initiatives. The Commission proposes to require reporting for cost reduction initiatives that are expected to cost the Postal Service at least \$5 million over the duration of the initiative.³¹⁸ Using the \$5 million threshold would limit any potential burden associated with reporting to the Postal Service's largest initiatives, where the greatest opportunities for cost reductions exist. The information sought is already collected by the Postal Service and therefore would impose no additional data collection burden on the Postal Service's part. This

³¹⁸ The Commission chooses \$5 million as the applicable threshold because such projects require the highest level of approval within the Postal Service. See United States Government Accountability Office, "Projected Capital Spending and Processes for Addressing Uncertainties and Risks," June 2018, at 7, available at: <https://www.gao.gov/assets/700/692859.pdf> (GAO Capital Report).

information would improve the measurement and tracking of the impact of such initiatives using the pre-determined metrics, as well as Market Dominant products' unit costs and total unit costs. This report would enable the Commission and postal stakeholders to better monitor the Postal Service's efforts to reduce costs and improve financial stability.

For each active and planned cost reduction initiative, the proposed rules would require the Postal Service to file a narrative that includes an overview of the initiative, including its status, the expected Postal Service expenditure on the initiative, the start date, the end date, and any intermediate deadlines. In addition, the proposed rules require the Postal Service to identify a specific metric to be used to measure the expected impact of each cost reduction initiative in future years, as well as a timeline detailing when the Postal Service expects to see the impact. Corresponding with the identified metric for each cost reduction initiative, the proposed rules require the Postal Service to estimate the cost reduction initiative's impact on both Market Dominant products' unit costs and total unit costs in future years.³¹⁹ These reporting requirements are designed to provide general information for all major cost reduction initiatives, as well as to serve as a baseline against which to monitor actual results in future fiscal years.

For each active cost reduction initiative, the proposed rules would require the Postal Service to file actual data detailing the impact of the cost reduction initiative on its selected metric, as well as the impact on Market Dominant unit costs and total unit costs. Then, the Postal Service would be required to compare the actual results to the expected results, and to provide a narrative explaining any variance along with a specific statement as to whether the initiative actually achieved the expected impact as measured by the selected metric. Finally, the Postal Service would be required to

³¹⁹ The proposed rules also account, however, for initiatives where the primary goal of the initiative may not be to reduce unit costs.

provide a description of any mid-implementation adjustments made to align actual results to expected results, as well as identify any revisions to expected results for future fiscal years. These reporting requirements would improve transparency by allowing the Commission and postal stakeholders to monitor cost reduction initiatives over time to ensure that the Postal Service continues its efforts to reduce costs and improve financial stability.

4. Decision Analysis Reports

Proposed § 3050.55(e) and (f) would require the provision of specific information pertaining to approved DARs. DARs are internal Postal Service documents used to justify and obtain approval for certain proposed capital spending projects. GAO Capital Report at 3. Specifically, a DAR is required for each capital spending project that has total costs over \$1 million.³²⁰ The Postal Service would be required to provide the following specific information for all projects associated with a DAR in the current or next fiscal year: descriptions of the projects; status of projects; estimates of cost savings or additional revenues for each project; and the expected return on investment from each project. This information would increase the transparency of the Postal Service's cost reduction efforts by providing additional insight into how the Postal Service is using its revenues. Requiring this reporting would ensure that the Commission and postal stakeholders have a complete picture of the Postal Service's efforts to reduce costs, including the investments it undertakes to do so. Providing this information would pose minimal additional administrative burden because these reports are already produced internally by the Postal Service.

³²⁰ DARs are required for projects over \$1 million and contain estimated cost, return-on-investment, and other information used to justify the project. *Id.* Capital projects from \$1 million to \$5 million must be approved by the Technical Review Committee. *Id.* Capital projects over \$5 million require the highest level of approval within the Postal Service and require that a DAR be submitted to the Investment Review Committee and then to the Postmaster General, who must give final approval. *Id.*

IX. PROCEDURAL IMPROVEMENTS

A. Introduction

Order No. 4258 proposed two procedural changes to improve the ratemaking process relating to planned rate adjustments of general applicability. First, the Commission proposed to enhance the schedule for regular and predictable rate adjustments. Order No. 4258 at 99-102. Existing 39 C.F.R. § 3010.9(e) requires the schedule for regular and predictable rate adjustments to be updated “[w]henever the Postal Service deems it appropriate....” 39 C.F.R. § 3010.9(e). The Commission proposed to require that the Postal Service update this schedule at least once a year. Order No. 4258 at 101. At a minimum, the Postal Service would update the schedule when it files the ACR. *Id.* The proposed rules would require the Postal Service to include the estimated filing and implementation dates (month and year), as well as an explanation that will allow mailers to predict with reasonable accuracy, by class, the amounts of planned rate adjustments. *Id.* The Postal Service would retain the flexibility to provide a new schedule at any time and may deviate from the anticipated rate changes if it provides an explanation in its notice of rate adjustment. *Id.*

Second, the Commission proposed to lengthen the notice period for rate adjustments and to make conforming adjustments to the timing of comments and the Commission’s decision. *Id.* at 102-106. The proposed rules would extend the notice period for rate adjustments from 45 days to 90 days before the planned implementation of rates. *Id.* at 104. The proposed rules would extend the comment deadline from 20 to 30 days for an initial request to review planned rate adjustments. *Id.* For an amended request, the proposed rules would extend the comment deadline from 7 to 10 days. *Id.*

The proposed rules would also lengthen the time period for rendering a Commission decision from 14 to 21 days after the comment period ends for both initial and amended requests. *Id.* The proposed rules also enumerate potential actions the

Commission may take if it determines that the Postal Service's request fails to include the required information. *Id.* at 104-105.

B. Comments

Pitney Bowes and NPPC *et al.* filed comments supporting the two procedural changes. Pitney Bowes asserts that the proposed rules would codify existing practice. Pitney Bowes Comments at 15. It credits the Postal Service for consistently providing more notice than is statutorily required to help mailers and mail service providers prepare to implement proposed rate adjustments. *Id.* Pitney Bowes supports extensions of both the comment and Commission review periods to facilitate more meaningful participation by interested persons as well as improved accountability. *Id.* It comments that the proposed rules specifying Commission actions in response to incomplete filings are also an improvement because “[t]he Commission cannot discharge its oversight responsibilities without access to accurate and complete information and the Postal Service is entitled to clear guidance as to potential responses from the Commission.” *Id.* at 15-16. Pitney Bowes concludes that the proposed procedural changes will help facilitate rate adjustment proceedings and should be adopted. *Id.* at 16.

NPPC *et al.* support the procedural change relating to the schedule for regular and predictable rate adjustments. NPPC *et al.* Comments at 80. They assert that the proposed rules may help provide additional guidance on the timing and size of rate adjustments in the near to medium future. *Id.* However, NPPC *et al.* express concern that the Postal Service may modify the schedule if it provides an explanation. *Id.* at 80-81. NPPC *et al.* state that the proposed rules do not specify any consequences if the Commission found the explanation to be unsatisfactory. *Id.* NPPC *et al.* also note that if the proposed rules were implemented, it would be reasonable to expect that the Postal Service would always file a schedule planning maximum rate adjustments. *Id.* at

81. They assert that it is unclear whether this will help mailers or cause them to leave the mailstream. *Id.*

The Postal Service opposes the proposed changes regarding the timing of rate adjustments. It asserts that the proposed rules create material changes, increase uncertainty for the Postal Service and mailers, and create practical issues that are inconsistent with Objectives 2, 5, and 6. Postal Service Comments at 149. The Postal Service notes that under the current rules, the Commission issues its decision regarding a rate adjustment 34 days after the initial filing.³²¹ It asserts that this decision period provides the Postal Service sufficient time to prepare and file an amended notice of rate adjustment at least 45 days before the implementation date as required.³²²

The Postal Service points out that the proposed rules would extend the Commission's decision period from 34 days to 51 days. Postal Service Comments at 149-150. It comments that the rationale behind this change is unclear given that Order No. 4258 did not cite any comments asserting that the current schedule does not allow adequate time for commenter review. *Id.* at 150. It asserts that because the proposed rules would continue to require that amended rates be filed 45 days before implementation, the Postal Service would not be able to maintain the planned 90-day implementation date if it were required to file amended rates. *Id.* at 150-151. As a result, the Postal Service contends that the Postal Service and mailers would no longer be able to rely on planned implementation dates because they would have to be deferred as a result of any remand. *Id.* at 151.

The Postal Service suggests that the Commission codify the 90-day overall notice requirement, but leave the existing timeframes for Commission decisions

³²¹ *Id.* This period includes 20 days for comments and a Commission order within 14 days of the conclusion of the public comment period. See 39 C.F.R. § 3010.11(a)(5), (d).

³²² Postal Service Comments at 149 (citing 39 U.S.C. § 3622(d)(1)(C); 39 C.F.R. § 3010.11(i)).

unchanged. *Id.* It notes that the Commission may shorten the pre-implementation notice window to fewer than 45 days. *Id.* However, the Postal Service recommends against increasing the notice period beyond 90 days. *Id.* at 151-152 n.327. It asks the Commission to recognize that 90 days' notice may be unnecessary for "small-scale price adjustments." *Id.* at 152. To allow pricing flexibility, the Postal Service suggests that the Commission preserve the existing practice of allowing the Postal Service to file notice of small-scale cases with 45 days' notice. *Id.*

The Postal Service also comments that the Commission should revisit existing § 3010.24, which requires volumes sent under NSAs to be included in billing determinants used for price cap calculations "as though they paid the appropriate rates of general applicability."³²³ It asserts that the use of uncapped NSA volumes to determine price cap space for non-NSA products is at tension with other Commission decisions in Docket No. RM2007-1. Postal Service Comments at 158. The Postal Service states that "the Commission's rules work a purely punitive effect: the Postal Service gets no additional cap authority when it offers discounted rates through an NSA...." *Id.* at 159. The Postal Service contends that the regulatory history in Order No. 26 supports the exclusion of NSA volumes from billing determinants used for price cap calculations.³²⁴ In their reply comments, NPPC *et al.* assert that changes to how NSAs are reflected in billing determinants are outside of the scope of this proceeding. NPPC *et al.* Reply Comments at 49.

³²³ *Id.* at 158 (quoting 39 C.F.R. § 3010.24(a)).

³²⁴ *Id.* (citing Order No. 26 at ¶ 2080).

C. Commission Analysis

Pitney Bowes and NPPC *et al.* support the proposed procedural changes.³²⁵ The Postal Service opposes the proposed changes extending the timeframes for comment periods and the Commission's decisions. Postal Service Comments at 149-151. It suggests that the Commission codify the 90-day overall notice requirement, but leave the timeframes for Commission decisions unchanged. *Id.* at 151.

The revised proposed rules retain the extended timeframes from the proposed rules. In Order No. 4257, the Commission determined that rate adjustment proceedings were consistently able to be adjudicated within 90 days. Order No. 4257 at 72. In each of the eight rate adjustments for all classes during the PAEA era, the Postal Service filed the notice of rate adjustment at least 90 days before the planned implementation date. *Id.* at 63. Extending the notice period from 45 to 90 days codifies this existing practice and facilitates the administration of rate adjustment proceedings. Order No. 4258 at 104. Ninety days' advance notice should also facilitate mailers' ability to generate budgets, allow adequate time for the proceeding to be adjudicated, and give mailers time to implement the rates as planned. *Id.*

Extending the comment and Commission review period will facilitate more meaningful participation and improved accountability. See Pitney Bowes Comments at 15. Allowing commenters 10 additional days to prepare comments will facilitate meaningful and intelligent participation by interested persons. Order No. 4258 at 104. Extending the comment deadline from 7 to 10 days on an amended notice of rate adjustment is consistent with extensions to the comment period made in prior proceedings. *Id.* Lengthening the timeframe for Commission decisions from 14 to 21 days after the comment period ends will better allow the Commission to evaluate each rate adjustment. *Id.*

³²⁵ Pitney Bowes Comments at 15-16; NPPC *et al.* Comments at 80.

The Postal Service asserts that it would not be able to maintain the planned 90-day implementation date if it were required to file amended rates. Postal Service Comments at 150-151. Under the existing rules, the Postal Service generally files notices of rate adjustment with more than the minimum 45 days' notice required by existing § 3010.10 to address this issue. See Order No. 4258 at 102-103. Under proposed § 3010.121(c) and (d), the Postal Service has the option to file a notice of rate adjustment with more than 90 days' notice. By exercising this option, the Postal Service will be able to address its concern that the Postal Service has sufficient time to address a remand prior to the planned implementation date.

The Postal Service asks the Commission to recognize that 90 days' notice may be unnecessary for "small-scale" rate adjustments and to allow the Postal Service to file small-scale cases with 45 days' notice. Postal Service Comments at 152. The Commission declines to provide an exception to the 90-day notice requirement. "Small-scale" rate adjustments are difficult to distinguish from rate adjustments that require 90 days' notice because small-scale rate adjustments may be just as complex as large-scale rate adjustments. Furthermore, mailers would benefit from 90 days' notice regardless of the size or complexity of rate adjustments. For example, NPPC *et al.* assert that 90 days' notice would "give the minimum notice that mailers need to conform their mailings systems, and should be adopted." NPPC *et al.* Comments at 81.

The Postal Service also comments that the Commission should revisit the substance of existing § 3010.24, which requires volumes sent under NSAs to be included in billing determinants used for price cap calculations. Postal Service Comments at 158-160. NPPC *et al.* reply that this issue falls outside of the scope of this rulemaking. NPPC *et al.* Reply Comments at 49-50. The Commission declines, in this proceeding, to consider changes to the treatment of NSA volumes for the purpose of determining compliance with the price cap. As the Commission stated in Order No. 26, "including negotiated service agreements in the test for compliance with the rate cap

may lead to rates for non-participating mailers that exceed the rate cap.” Order No. 26 at ¶ 2080.

NPPC *et al.* express concerns that the proposed rules allow the Postal Service to file a revised schedule of rate adjustments anytime and that the Postal Service may vary the magnitude of such rate adjustments if it provides an explanation. NPPC *et al.* Comments at 80-81. Revised § 3010.102 contains the substance of existing § 3010.9, which allows the Postal Service to file a revised schedule and explanation with the Commission “[w]henever the Postal Service deems it appropriate to change the Schedule for Regular and Predictable Rate Adjustments[.]” See 39 C.F.R. § 3010.9(e). Both revised § 3010.102 and existing § 3010.9 are consistent with the statutory requirement that the modern system of ratemaking “establish a schedule whereby rates, when necessary and appropriate, would change at regular intervals by predictable amounts[.]” See 39 U.S.C. § 3622(d)(1)(B). Revised § 3010.102 reflects the Postal Service’s pricing flexibility to revise the schedule of rate adjustments and vary the magnitude with an explanation. Such pricing flexibility is necessary because the exact amount of rate authority is not known with precision until shortly before a rate adjustment is filed. If the Postal Service modifies the rate schedule without providing a satisfactory explanation, the Commission will address this issue on a case-by-case basis in future proceedings.

NPPC *et al.* are also concerned that under the proposed rules, the Postal Service would file a schedule reflecting the maximum rate adjustments. NPPC *et al.* Comments at 81. The Commission observes that this would be an allowable use of the Postal Service’s pricing flexibility under both the current and proposed rules.

D. Commission Proposal

The revised proposed rules concerning the procedures for rate adjustment dockets retain the substance and structure of the proposed rules. Changes were made

for clarity, global consistency, and terminology. For example, the term “request” was used in the proposed rules to refer to the material submitted by the Postal Service to the Commission pursuant to a rate adjustment filing. Order No. 4258 at 109. The revised proposed rules use the term “rate adjustment filing” instead of “request.” The revised proposed rules also replace “approved analytical principles” with “accepted analytical principles” to be consistent with 39 C.F.R. § 3050.1(a).

Other procedural rules were changed to conform to changes proposed elsewhere in this Order. For instance, the revised definitions, which appear in revised § 3010.101, would reflect the forms of rate authority newly proposed in this Order (density-based rate authority and retirement obligation rate authority). Revised § 3010.123 specifies the supporting technical documentation that the Postal Service must provide with its rate adjustment filing. The revised proposed rules contain the same requirements as the proposed rules, but add the requirement that the Postal Service designate how much of each type of rate adjustment authority is planned for use for each class.

In addition, the revised proposed rules adopt a different approach to the relationship between the system of ratemaking and the objectives and factors of 39 U.S.C. § 3622(b) and (c). In *Carlson v. Postal Regulatory Commission*, the United States Court of Appeals for the District of Columbia Circuit found that the Commission is required to consider the statutory objectives and factors of 39 U.S.C. § 3622(b) and (c) in rate adjustment proceedings.³²⁶ The court based its decision in part on the Commission’s existing rules in 39 C.F.R. part 3010.³²⁷ Notwithstanding this decision,

³²⁶ *Carlson v. Postal Reg. Comm’n*, 938 F.3d 337, 343-344 (D.C. Cir. 2019).

³²⁷ See 39 C.F.R. § 3010.12(b)(7) (requiring the Postal Service to provide a discussion, in each proposed rate adjustment, of how the adjustment is “designed to help achieve the objectives listed in 39 U.S.C. 3622(b) and properly take into account the factors listed in 39 U.S.C. 3622(c).”) and 39 C.F.R. § 3010.11(e) (stating that “[i]f the planned rate adjustments are found consistent with applicable law by the Commission, they may take effect pursuant to appropriate action by the Governors[]”). See also *Carlson*, 938 F.3d at 343, 345.

the Commission has authority to construe how to apply the provisions of 39 U.S.C. § 3622, including paragraphs (b), (c), and (d)(3).³²⁸ Under the modified system of ratemaking proposed in this rulemaking, the Commission proposes to discontinue addressing the objectives and factors in individual rate adjustment proceedings. Revised § 3010.121, § 3010.122, and § 3010.126 reflect this proposed change in approach.

Furthermore, to improve global consistency throughout the Commission's existing rules in 39 C.F.R. part 3020, changes are proposed regarding modifications to the product list, material changes to product descriptions, and minor corrections to product descriptions. The proposed changes, which appear in revised §§ 3020.32, .52, .72, .81, .82, .90, and .91, are in accordance with *U.S. Postal Serv. v. Postal Reg. Comm'n*, 886 F.3d 1261, 1270 (D.C. Cir. 2018).

³²⁸ *Carlson* did not rest on the premise that the PAEA unambiguously required the Commission to apply the objectives and factors in rate adjustments; instead, the court acknowledged the discretion of the Commission with regard to the application of the objectives and factors to rate adjustments. *See Carlson*, 938 F.3d at 344 (citing 39 U.S.C. § 3622(a)-(c)) ("Congress left the Commission leeway to establish, through regulation, a process for considering the PAEA's objectives and factors."). Further, *Carlson* did not evaluate the Commission's authority under 39 U.S.C. § 3622(d)(3). "A court's prior construction of a statute trumps an agency construction otherwise entitled to *Chevron* deference only if the prior court decision holds that its construction follows from the unambiguous terms of the statute and thus leaves no room for agency discretion." *Nat'l Cable & Telecomms. Ass'n v. Brand X Internet Servs.*, 545 U.S. 967, 982 (2005) (citing *Smiley v. Citibank (S.D.)*, N.A., 517 U.S. 735, 740-741 (1996)).

X. 5-YEAR REVIEW (FORMERLY SAFEGUARDS)

A. Commission Proposal

The Commission first solicited comments on its initial framework for reviewing the modern system of regulating rates and classes for Market Dominant products in an Advance Notice of Proposed Rulemaking. See Order No. 3673. Several commenters, including the Public Representative and the Postal Service, suggested near term reviews of any regulatory changes resulting from the Commission's final changes to its regulations.³²⁹

In Order No. 3673, the Commission proposed a 5-year review period³³⁰ tied to the expiration of the 2 percent supplemental rate authority. In support of this time period, the Commission stated that a 5-year time frame would enable it to “revisit [the] plan’s performance quickly enough to prevent either persistent windfalls...that harm consumers or persistent revenue shortfalls that damage the producer.” Order No. 4258 at 37. In response to commenters who advocated for shorter review periods in their comments on Order No. 3673, the Commission noted, “reviewing the system too

³²⁹ See 2017 PR Comments at 60-61; 2017 Postal Service Comments at 219 n.430.

³³⁰ Courts typically provide substantial deference to regulatory agencies when determining time periods for review of rate design implementation. See *Elec. Consumers Res. Council v. F.E.R.C.*, 407 F.3d 1232, 1239 (D.C. Cir. 2005) (“[T]he court will defer to the Commission's predictive judgment that the new rate design will result in ‘more good than harm,’ as long as the Commission articulates reasons for its judgment and responds adequately to [opposing party’s] objections.”); *Texas Office of Public Utility Counsel v. F.C.C.*, 265 F.3d 313, 322-23 (5th Cir. 2001), *cert. denied*, 535 U.S. 986 (2002) (accepting FCC articulation of rationale to change prior policy and increase subscriber line charge (SLC) for residential and single-line business customers – dramatic market changes in industry in last few years, dynamic market, tension between statutory goals, transition growing pains, minimized affordability concerns, promise to conduct cost-study before adjustment); *Ass’n of Oil Pipe Lines v. F.E.R.C.*, 83 F.3d 1424, 1437 (D.C. Cir. 1996)) (noting that even the appellant were correct that over time the producer price index (PPI-1) percent would result in an overly generous price cap, FERC had announced it would conduct a general review of the index formula after 5 years’ experience).

frequently can undermine the incentives towards efficiency that the price cap was intended to foster.” *Id.*

B. Comments

The Public Representative, relying on declarations of Kwoka and Wilson, recommends that the next Commission review period be shortened to 3 years.³³¹ He points to fast moving changes in underlying conditions – such as continuing financial losses, defaults of prepayment obligations, the need for capital investment, and the possibility of comprehensive postal reform by Congress – which will require the Postal Service to possess increased resources to respond.³³²

Netflix proposes a nuance to the 5-year review period that allows for interim reviews and opportunities for making adjustments. Netflix Comments at 4. It asserts that a flexible process is essential in order to correct inaccurate or disputed data and assumptions about a highly uncertain future. *Id.* It states that such a proposal adequately balances the objectives of predictability and reduces administrative burden with the ones for just and reasonable rates, financial stability, and more efficient operations. *Id.* at 10. According to Netflix, “establishing a five-year plan already provides mailers a degree of predictability which is not materially diminished by allowing interim adjustments.” *Id.* It suggests that the Commission could limit the issues raised in an interim review and adopt expedited procedures for special adjustments, similar to those used in exigency cases. *Id.*

³³¹ PR Comments at 62 (citing Kwoka/Wilson Declaration at 17-18).

³³² PR Comments at 62 (citing Kwoka/Wilson Declaration at 18-19).

C. Commission Analysis

It will take one or more rate cycles before data are available to assess the changes contemplated in the instant docket in a comprehensive manner. To properly assess the effectiveness of the new regulations, the Commission has determined that 5 years is the optimal review period. This approach remains consistent with the statutory authority granted by 39 U.S.C. § 3622(d)(3), which provides that the Commission's review of the system for regulating rates and classes for Market Dominant products shall take place 10 years after the date of enactment of the PAEA and "as appropriate thereafter." The Commission views a 5-year review period as most appropriate because it balances the competing needs of sufficient time to allow the effects of the changes to be fully known with a review period short enough to protect postal stakeholders from unintended consequences stemming from the changes. Although no longer tied to the expiration of the supplemental rate authority, the 5-year mark is still sufficient to assess both the effects of the changes and the evolving economic trends that may affect the mailing industry. A shorter time period, such as the 3 year review period suggested by the Public Representative, would only show the effects of two rate cycles, which would not allow the cumulative effects to be fully explored.

During those 5 years, the Commission will continue to monitor the system through its annual compliance and periodic reporting processes, among others. The Commission's extensive experience monitoring the postal industry landscape informs it that the surrounding environment is often subject to rapid and unexpected change. As such, the Commission notes that if such a change occurs before the 5-year review period, it is prepared to respond as necessary. In response to the issue of potential legislation raised by Netflix, in the event of a significant change in circumstances, such as if Congress enacts postal reform legislation within these 5 years, the Commission will promptly reassess any portions of its new and existing regulations that are impacted.

XI. SECTION-BY-SECTION ANALYSIS OF THE PROPOSED CHANGES TO 39 C.F.R. PART 3010, AS REVISED

A. Proposed Subpart A of 39 C.F.R. Part 3010—General Provisions

Section 3010.100, Applicability. Proposed § 3010.100(a) explains that the rules of this part apply to rate adjustments for Market Dominant rates of general applicability. It also identifies 39 U.S.C. chapter 36, subchapter I as the relevant statutory authority and the Mail Classification Schedule (MCS) posted on the Commission's website as a source for current rates.

Proposed § 3010.100(b) acts as an index to direct the public to the rules for periodic rate adjustments subject to regulatory limitations, the calculations of the regulatory limitations, rate adjustments due to extraordinary or exceptional circumstances, and special rules for workshare discounts.

Section 3010.101, Definitions. Proposed § 3010.101 replaces the definitions appearing in existing § 3010.1. For the most part, the purported definitions in existing § 3010.1 act more as a table of contents than as a source for definitions. This may have been necessary to give meaning to the Type 1-A, 1-B, and 1-C terminology appearing in the current rules. However, it is no longer necessary due to the elimination of this terminology. Proposed § 3010.101 provides definitions for: annual limitation, banked rate authority, class, density rate authority, maximum rate adjustment authority, performance-based rate authority, rate authority applicable to non-compensatory classes, rate cell (existing § 3010.23(a)(2)), rate incentive (existing § 3010.23(a)(3)), rate of general applicability (existing § 3010.1(g)), retirement obligation rate authority, and seasonal or temporary rate.

Section 3010.102, Schedule for regular and predictable rate adjustments. Proposed § 3010.102 incorporates existing § 3010.9, which concerns the Schedule for Regular and Predictable Rate Adjustments. To improve transparency, and ensure both

the mailers and the Commission are aware of the Postal Service's current intent concerning future rate adjustments, proposed § 3010.102 requires the Postal Service to specifically address plans to adjust rates that may occur over the next 3 years, at a minimum. The Commission will continue to post the schedule provided by the Postal Service on the Commission's website. Proposed § 3010.102 also requires the Postal Service to update and file a schedule annually at the time it files its ACR pursuant to 39 U.S.C. § 3652. For convenience, the Commission prefers that the schedule be filed as part of the Annual Compliance Review docket, *i.e.*, under the applicable Annual Compliance Review docket number. Consistent with existing § 3010.9, the Postal Service must update the schedule when necessary.

B. Proposed Subpart B of 39 C.F.R. Part 3010—Rate Adjustments

Section 3010.120, General. This section identifies the rules in proposed subpart B of 39 C.F.R. part 3010 as applicable to periodic rate adjustments subject to regulatory limitations.

Section 3010.121, Postal Service rate adjustment filing. Proposed § 3010.121(c) incorporates the public notice requirement, which appears in existing § 3010.10(a)(1). Proposed § 3010.121(d) incorporates the requirement to submit a request to the Commission to review the Postal Service's notice of rate adjustment, which appears in existing § 3010.10(a)(2). Proposed § 3010.121(c) and (d) extend the notice and filing periods from 45 to 90 days. With this extension, the aspirational goal of providing a longer notice, appearing in existing § 3010.10(b), is deleted because it is no longer necessary.

Proposed § 3010.121(b) modifies existing § 3010.12(b)(7) to reflect that the Postal Service shall consider the provisions of 39 U.S.C. chapter 36. There is no reporting requirement for this paragraph.

Section 3010.122, Contents of a rate adjustment filing. This section specifies the general contents of the Postal Service's rate adjustment filing. Existing § 3010.12, which includes these requirements, is divided into two separate sections: proposed §§ 3010.122 and 3010.123. Proposed § 3010.122 provides requirements for the general contents of a Postal Service rate adjustment filing, which appear in existing § 3010.12(a), (b)(8), (b)(10), (b)(11), and (b)(12). Proposed § 3010.123 provides requirements for the technical data (calculations) necessary to support the rate adjustment filing. Proposed § 3010.122(f) ties the general requirements of proposed § 3010.122 to the technical requirements of proposed § 3010.123. Proposed § 3010.123 encompasses the remaining items appearing in existing § 3010.12.

There are two notable changes from the current rules. First, proposed § 3010.122(b) extends the public notice period from at least 45 days to at least 90 days. Second, proposed § 3010.122(h) requires the Postal Service to certify that it has used the most recently accepted analytical principles in its rate adjustment filing. Existing § 3010.12(f) requires the Postal Service to use the most recently accepted analytical principles, but there is no certification requirement. This change will reinforce the current requirement, and provide the Postal Service with an opportunity to identify any challenges or limitations on complying with this requirement.

Section 3010.123, Supporting technical documentation. This section specifies the supporting technical documentation that the Postal Service is to provide with its rate adjustment filing. Proposed § 3010.123(a) describes the form for any workpapers that must be submitted with the rate adjustment filing, e.g., show all calculations, identify sources, submit in machine-readable, electronic format, link to spreadsheet cells. Similar requirements are spread throughout the existing rules.

Then, the remaining paragraphs describe the technical documentation that must be provided with each rate adjustment filing. Proposed § 3010.123(b) through (d) and (f) through (i) specify technical supporting data to be filed with the Postal Service's rate

adjustment filing, which appear in existing § 3010.12(b)(1), (b)(2), (b)(3), (b)(4), (b)(5), (b)(9), (c), (d), and (e). These paragraphs address the provision of information concerning: the calculation of the maximum rate adjustment authority; the schedule of banked rate authority; the calculation of the percentage change in rates; the calculation of unused rate adjustment authority; a schedule of workshare discounts; new workshare discounts; new discounts or surcharges not considered a workshare discount; and rate incentives.

Proposed § 3010.123(e) requires that the Postal Service provide calculations showing the Postal Service's planned usage of each type of rate adjustment authority, by class: density rate authority (proposed subpart D of 39 C.F.R. part 3010), retirement obligation rate authority (proposed subpart E of 39 C.F.R. part 3010), performance-based rate authority (proposed subpart F of 39 C.F.R. part 3010), and non-compensatory rate authority (proposed subpart G of 39 C.F.R. part 3010).

Proposed § 3010.123(k) requires that the Postal Service provide information associated with products or classes where the attributable cost for that class or product exceeded the revenue from that class or product as determined by the Commission.

The requirements of existing § 3010.12(b)(6) concerning justifications for workshare discounts that exceed attributable costs are replaced by the material appearing in proposed subpart J of 39 C.F.R. part 3010, Rates Applicable to Workshare Discounts and do not appear in proposed § 3010.123.

Section 3010.124, Docket and notice. Proposed § 3010.124 incorporates the rules concerning the establishment of a docket and the Commission's notice of proceedings, which appear in existing § 3010.11(a). The content is unchanged except for the extension of the public comment period from 20 to 30 days.

Section 3010.125, Opportunity for comments. Proposed § 3010.125 simplifies the wording of existing § 3010.11(b) and (c) to allow comments on whether the planned

rate adjustments comport with applicable statutory and regulatory requirements. As always, the Commission reserves the right to limit comments to those relevant to the rate adjustment proceeding before the Commission.

Section 3010.126, Proceedings. This section specifies the general flow of a proceeding applicable to a request to review a notice of rate adjustment.

Proposed § 3010.126(a) prescribes potential Commission action when the Postal Service's request does not substantially comply with the filing requirements concerning the contents of a rate adjustment filing and the required supporting technical documentation. The Commission may: inform the Postal Service of the deficiencies and provide an opportunity for the Postal Service to take corrective action, toll or otherwise modify the procedural schedule until the Postal Service takes corrective action, dismiss the rate adjustment filing without prejudice, or take other action as deemed appropriate by the Commission.

Proposed § 3010.126(b) through (j) contains the general procedures for reviewing rate adjustment filings, which appear in existing § 3010.11(d) through (k). The applicable law at issue in a rate adjustment proceeding refers to the applicable requirements of 39 C.F.R. part 3010, Commission directives and orders, and 39 U.S.C. §§ 3626, 3627, and 3629. Additionally, several time periods are modified. The time period from the conclusion of the comment period to the Commission issuing a determination is increased from 14 to 21 days. The comment period concerning any amended notice is increased from 7 to 10 days. The time period from the receipt of an amended notice to the Commission issuing a determination is increased from 14 to 21 days.

Section 3010.127, Maximum rate adjustment authority. This section specifies the calculation of the maximum rate adjustment authority, and imposes limitations on certain rate decreases. Proposed § 3010.127 replaces existing § 3010.20. The fundamental differences between the current rules and the new rules are the expanded

sources for potential rate adjustment authority available under the new rules. The current rules determine a maximum allowable rate adjustment based upon an annual limitation (CPI rate authority), or if the annual limitation is entirely used, the annual limitation plus available banked rate authority (up to 2 percent). The new rules add four sources of potential rate adjustment authority to the CPI rate authority (proposed subpart C of 39 C.F.R. part 3010) and the banked rate authority (proposed subpart H of 39 C.F.R. part 3010) when determining the maximum allowable rate adjustment: density rate authority (proposed subpart D of 39 C.F.R. part 3010), retirement obligation rate authority (proposed subpart E of 39 C.F.R. part 3010), performance-based rate authority (proposed subpart F of 39 C.F.R. part 3010), and non-compensatory rate authority (proposed subpart G of 39 C.F.R. part 3010). The availability of each of these sources is subject to limitations appearing in each of the new subparts. The maximum rate adjustment authority available to the Postal Service for each class of Market Dominant mail is limited to the sum of the percentage points developed in each of these subparts.

Existing § 3010.20(e) imposes no limitation on the amount of a rate decrease. Proposed § 3010.127(b) prohibits the reduction of rates for non-compensatory products. There is no limitation on the amount of a rate decrease for any other product.

Section 3010.128, Calculation of percentage change in rates. This section specifies the calculation of percentage change in rates. Proposed § 3010.128 combines the content of existing § 3010.23, concerning the calculation of percentage change in rates, and existing § 3010.24, concerning the treatment of volumes associated with NSAs and rate incentives not of general applicability. There is no intent to change the meaning or operation of the rules currently in place.

Proposed § 3010.128(a) incorporates the content of existing § 3010.23(a)(1).³³³ Proposed § 3010.128(a) defines “current rate” as used in this section and provides two exceptions to the definition. The definitions for “rate cell” and “rate incentive” appearing in existing § 3010.23(a)(2) and (3) are added to other definitions appearing in proposed § 3010.101.

Proposed § 3010.128(b) describes the determination of volumes associated with each rate cell, which appears in existing § 3010.23(d).

Proposed § 3010.128(c) describes the process for calculating the percentage change in rates when rates are being increased, which appears in existing § 3010.23(b)(1).

Proposed § 3010.128(d) describes the process for calculating the percentage change in rates when rates are being decreased, which appears in existing § 3010.23(b)(2).

Proposed § 3010.128(e) provides the formula for calculating the percentage change in rates, which appears in existing § 3010.23(c).

Proposed § 3010.128(f) describes the treatment of volume associated with rate incentives where the rates are not of general applicability, which appears in existing § 3010.23(e).

Proposed § 3010.128(g) describes the treatment of volume associated with NSAs and rate incentives not of general applicability, which appears in existing § 3010.24.

Section 3010.129, Exceptions for de minimis rate increases. This section provides exceptions to the requirements to immediately calculate the maximum rate

³³³ The example included in existing § 3010.23(a)(1)(iii) is omitted because it more appropriately belongs in a description of the rule, and not in the rule itself. The example remains factually accurate.

adjustment authority and bank unused rate adjustment authority in the case of *de minimis* rate increases. Proposed § 3010.129 specifies the rules for *de minimis* rate increases, which appear in existing § 3010.30. There is no intent to change the meaning or operation of the rules currently in place. Additionally, proposed § 3010.129(g) prohibits the reduction of rates for non-compensatory products.

C. Proposed Subpart C of 39 C.F.R. Part 3010—Consumer Price Index Rate Authority

Section 3010.140, Applicability. This section informs the public that rate adjustment authority is available based upon changes in the CPI-U. Rate adjustment authority calculations differ depending on whether the rate adjustment is being filed 12 or more months from the previous rate adjustment (proposed § 3010.142), or less than 12 months from the previous rate adjustment (proposed § 3010.143).

Section 3010.141, CPI-U data source. Proposed § 3010.141 unifies the duplicative rules for the source of the data for the CPI-U values, which appear in existing §§ 3010.21(a) and 3010.22(b).

Section 3010.142, CPI-U rate authority when rate adjustment filings are 12 or more months apart. Proposed § 3010.142 specifies the rules to calculate the CPI-U rate authority when rate adjustment filings are 12 or more months, which appear in existing § 3010.21(b).

Section 3010.143, CPI-U rate authority when rate adjustment filings are less than 12 months apart. Proposed § 3010.143 specifies the rules to calculate the CPI-U rate authority when rate adjustment filings are less than 12 months apart, which appear in existing § 3010.2(b) through (d).

D. Proposed Subpart D of 39 C.F.R. Part 3010—Density Rate Authority

Section 3010.160, Applicability. This section informs the public of the availability of rate authority to address the effects of decreases in density of mail. By December 31 of each year, the Postal Service must file a notice that calculates the amount of the density rate authority that is eligible for authorization. This notice will be reviewed by the Commission and the Commission shall announce how much, if any, density rate authority will be authorized. The rate authority must be applied, if at all, to the first generally applicable rate increase filed after the Commission's annual announcement. The rate authority will be made available to the Postal Service on the date of the Commission's announcement and lapses 12 months later if unused. The unused portion may not be banked for future use. The Commission intends to also apply the no banking rule (proposed § 3010.160(b)(4)) to any attempt to circumvent the intent of this provision, such as filing a rate increase immediately followed by the filing of a rate decrease in order to create banked rate authority.

Section 3010.161, Density calculation data sources. This section specifies the sources of the data for the calculation of the density rate authority.

Section 3010.162, Calculation of density rate authority. This section specifies the timing, formulas, and steps involved for calculating the amount of density rate authority and the percentage change in density from the prior fiscal year.

E. Proposed Subpart E of 39 C.F.R. Part 3010—Retirement Obligation Rate Authority

Section 3010.180, Definitions. This section defines four terms used in this subpart: amortization payments, phase-in period, required minimum remittance, and revenue collected under this subpart.

Section 3010.181, Applicability. This section informs the public of the availability of rate authority to provide the Postal Service with revenue for remittance towards the

statutorily mandated amortization payments for the following supplemental and unfunded liabilities: RHBs as computed under 5 U.S.C. § 8909a(d)(2)(B) and (d)(3)(B)(ii); the CSRS as computed § 8348(h)(2)(B); and the FERS as computed under § 8423(b)(1)(B), (b)(2), and (b)(3)(B). By December 31 of each year, the Postal Service must file a notice that calculates the amount of the retirement obligation rate authority that is eligible for authorization. This notice will be reviewed by the Commission and the Commission shall announce how much, if any, retirement obligation rate authority, will be authorized. The rate authority must be applied, if at all, to the first generally applicable rate increase filed after the Commission's annual announcement. The rate authority will be made available to the Postal Service on the date of the Commission's announcement and lapses 12 months later if unused. The unused portion may not be banked for future use. The Commission intends to also apply the no banking rule (proposed § 3010.180(b)(5)) to any attempt to circumvent the intent of this provision, such as filing a rate increase immediately followed by the filing of a rate decrease in order to create banked rate authority.

Section 3010.182, Retirement obligation data sources. This section specifies the sources of the data for the calculation of the retirement obligation rate authority. The amounts of the amortization payments shall be obtained from the annual determinations appearing in the OPM notifications to the Postal Service. Other values needed for the calculation shall be obtained from the Revenue, Pieces, and Weight report filed by the Postal Service.

Section 3010.183, Calculation of retirement obligation rate authority. This section specifies the timing, formulas, and steps involved for calculating the amount of retirement obligation rate authority. Pending satisfaction of the conditions, the retirement obligation rate authority will be available for 5 consecutive fiscal years and will be reamortized for each fiscal year.

Section 3010.184, Required minimum remittances. If the Postal Service elects to use any of the retirement obligation rate authority, proposed § 3010.184(a) requires the Postal Service to remit the amount of revenue collected (at minimum) toward the supplemental and unfunded liabilities. Proposed § 3010.184(b) and (c) specify the formula and steps involved for calculating the minimum amount of the remittance.

Section 3010.185, Forfeiture. This section specifies the three circumstances under which retirement obligation rate authority may not be made available to the Postal Service and the Commission may institute further proceedings.

F. Proposed Subpart F of 39 C.F.R. Part 3010—Performance-Based Rate Authority

Section 3010.200, Applicability. This section informs the public of the availability of 1 percentage point of rate authority per class of mail based upon the Postal Service meeting or exceeding an operational efficiency-based requirement and adhering to a service standard-based requirement. By December 31 of each year, the Postal Service shall file a notice with the Commission demonstrating whether or not both requirements are met. After review of this Postal Service notice and any challenges filed pursuant to proposed § 3010.202(b), the Commission shall announce how much performance-based rate authority, if any, will be allocated. If the Commission determines that both requirements are met, 1 percentage point of rate authority shall be allocated.

The rate authority will be made available to the Postal Service on the date of the Commission's announcement and lapse 12 months later if unused. If unused, or if not fully used, the unused portion may not be banked for future use. The Commission intends to also apply the no banking rule (proposed § 3010.200(b)(4)) to any attempt to circumvent the intent of this provision, such as filing a rate increase immediately followed by the filing of a rate decrease in order to create banked rate authority.

Section 3010.201, Operational efficiency-based requirement. This section provides the criteria for the operational efficiency-based requirement: the TFP for the measured fiscal year must exceed the TFP for the previous fiscal year.

Section 3010.202, Service standard-based rate requirement. This section provides the criteria for the service standard-based requirement: for each class of mail, all of the Postal Service's service standards (including applicable business rules) for that class during the applicable year must meet or exceed the service standards in place during the prior fiscal year on a nationwide or substantially nationwide basis. This test examines the service standards and the business rules. It does not examine actual service performance such as time-to-delivery.

The Postal Service's notice concerning its adherence to the service standard-based requirement may be challenged. Any interested person may challenge the notice by March 15, of each year. Once challenged, the Commission shall rule on the challenge as soon as practicable. The subject matter of the challenge is limited to changes in service standards or business rules that occur on a national or substantially nationwide basis. Whether or not the Postal Service is meeting its service standards shall not be the subject of this form of challenge.

G. Proposed Subpart G of 39 C.F.R. Part 3010—Non-Compensatory Classes or Products

Section 3010.220, Applicability. If the attributable cost for a product within a class of mail exceeded the revenue from that product, *i.e.*, the product is non-compensatory, then the rate-setting criteria of proposed § 3010.221 apply to that product. If the attributable cost for any class of mail exceeded the revenue from that class, *i.e.*, the class is non-compensatory, then proposed § 3010.222 applies to that class.

Section 3010.221, Individual product requirement. For non-compensatory products, the Postal Service shall increase the rate of the product by a minimum of 2 percentage points above the percentage increase of the class that includes the non-compensatory product. Rates for the compensatory products in the class shall be adjusted accordingly. This section does not create additional rate adjustment authority for the class.

Section 3010.222, Class requirement and additional class rate authority. Proposed § 3010.222(a) provides 2 percentage points of additional rate authority for non-compensatory classes.

Proposed § 3010.222(b) prescribes that the rate authority must be applied, if at all, to the first generally applicable rate increase filed after the Commission's annual announcement. The rate authority will be made available to the Postal Service on the date of the Commission's announcement and lapses 12 months later if unused. If unused, or if not fully used, the unused portion may not be banked for future use. The Commission intends to also apply the no banking rule (proposed § 3010.222(c)(4)) to any attempt to circumvent the intent of this provision, such as filing a rate increase immediately followed by the filing of a rate decrease in order to create banked rate authority.

H. Proposed Subpart H of 39 C.F.R. Part 3010—Accumulation of Unused and Disbursement of Banked Rate Adjustment Authority

Section 3010.240, General. This section requires the Postal Service to calculate unused rate adjustment authority, and, if applicable, revise the schedule of banked rate adjustment authority, whenever it plans to adjust rates. Limited exceptions to this rule apply, such as when the Postal Service requests review of a *de minimis* rate adjustment.

Section 3010.241, Schedule of banked rate adjustment authority. Proposed § 3010.241 expands the requirements concerning the schedule of banked rate adjustment authority, which appear in existing § 3010.26(f), to include a list of items that must be tracked within the schedule. The schedule must include the availability of banked rate adjustment authority (before and after filing rate adjustments), along with the sources, amounts, and dates associated with any changes to the schedule.

Section 3010.242, Calculation of unused rate adjustment authority for rate adjustments that involve a rate increase which are filed 12 months apart or less. Proposed § 3010.242(a) incorporates the requirements concerning the calculation of unused rate adjustment authority that involve rate increased filed 12 months apart or less, which appear in existing § 3010.26(b). The existing calculation rule is changed to reflect that the maximum rate adjustment authority may include CPI, density, retirement obligation, performance-based, and non-compensatory rate authority, whereas CPI rate authority is currently the only source of new rate adjustment authority. Otherwise, there is no intent to change the meaning or operation of the rules currently in place.

Proposed § 3010.242(b) imposes a requirement where a class of mail is non-compensatory. In that instance, unused rate adjustment authority cannot be generated or banked. Potential unused rate adjustment authority that may be banked is assumed to be zero. This also forecloses the possibility of banking negative rate authority in times of deflation.

Proposed § 3010.242(c) limits the maximum amount of unused rate adjustment authority that can be banked to the unused portion of the CPI rate authority.

Section 3010.243, Calculation of unused rate adjustment authority for rate adjustments that involve a rate increase which are filed more than 12 months apart. Proposed § 3010.243(a) through (c) incorporates the requirements concerning the calculation of unused rate adjustment authority for rate adjustments that involve a rate increase which are filed more than 12 months apart, which appear in existing

§ 3010.26(c). The rules are restructured to make it clear that interim rate adjustment authority must be calculated first and that amount must be immediately added to the bank. Then, unused rate adjustment authority may be calculated.

Proposed § 3010.243(b) incorporates the formula for calculating the interim rate adjustment authority, which appears in existing § 3010.26(c)(2). There is no intent to change the meaning or operation of the existing rule.

Proposed §3010.243(c) incorporates the requirements concerning the calculation of unused rate adjustment authority, which appear in existing § 3010.26(b). The existing calculation rule is changed to reflect that the maximum rate adjustment authority may include CPI, density, retirement obligation, performance-based, and non-compensatory rate authority, whereas CPI rate authority is currently the only source of new rate adjustment authority. Otherwise, there is no intent to change the meaning or operation of the rules currently in place. The calculations appearing in proposed §§ 3010.242(a) and 3010.243(c) are essentially the same.

Proposed § 3010.242(d) prohibits the generation or banking of unused rate adjustment authority for a class of mail that is non-compensatory. Potential unused rate adjustment that may be banked is assumed to be zero. This also forecloses the possibility of banking negative rate authority in times of deflation.

Proposed § 3010.242(e) limits the maximum amount of unused rate adjustment authority that can be banked to the unused portion of the CPI rate authority.

Section 3010.244, Calculation of unused rate adjustment authority for rate adjustments that only include rate decreases. Proposed § 3010.244 incorporates the requirements concerning the calculation of unused rate adjustment authority for rate adjustments that only include rate decreases, which appear in existing § 3010.27. The existing calculation rule is changed to reflect that the maximum rate adjustment authority may include CPI, density, retirement obligation, performance-based, and non-

compensatory rate authority, whereas CPI rate authority is currently the only source of new rate adjustment authority. Otherwise, there is no intent to change the meaning or operation of the rules currently in place.

Proposed § 3010.244(c) limits the maximum amount of unused rate adjustment authority that can be banked to the unused portion of the CPI rate authority, referenced back to the most recent rate adjustment filing that involved a rate increase.

Proposed § 3010.244(f) incorporates the prohibition relating to possible interactions with exigent rate requests, which appears in existing § 3010.6(b)(2).

Section 3010.245, Application of banked rate authority. This section explains how previously banked rate authority may be applied to a rate adjustment request. Proposed § 3010.245(b) contains the requirement that all CPI rate authority must be used before banked rate authority can be used, which appears in existing § 3010.25. The existing rule is changed to reflect that the proposed rate adjustment authority may include CPI, density, retirement obligation, performance-based, and non-compensatory rate authority, whereas CPI rate authority is currently the only source of new rate adjustment authority. Otherwise, there is no intent to change the meaning or operation of the rule currently in place.

Proposed § 3010.245(c) contains the limitation on the use of banked rate adjustment authority to 2 percent in any 12-month period, which appears in existing § 3010.29. Whenever this authority is used, the schedule of banked rate adjustment authority must be modified accordingly, as of the date of the final order accepting the rates.

Proposed § 3010.245(d) incorporates the explanation of how interim rate authority may be used, which appears in existing §3010.26(d).

Proposed § 3010.245(e) incorporates the explanation that banked rate adjustment authority must be used utilizing the first-in, first-out (FIFO) method beginning

5 years before the filing date of the instant notice, which appears in existing § 3010.28. The existing wording is changed for consistency with other paragraphs of this section.

Proposed § 3010.245(f) incorporates the explanation that banked rate adjustment authority lapses 5 years from the filing date of the request leading to its calculation, which appears in existing § 3010.26(e).

I. Proposed Subpart I of 39 C.F.R. Part 3010—Rate Adjustments Due to Extraordinary and Exceptional Circumstances

Proposed 39 C.F.R. part 3010, subpart H (proposed § 3010.260 *et seq.*) incorporates the requirements concerning exigent rate increases, which appear in existing 39 C.F.R. part 3010, subpart E (existing § 3010.60 *et seq.*). There is no intent to change the meaning or operation of the rules currently in place. However, the order in which the material appears has changed, along with some material being reorganized amongst paragraphs.

J. Proposed Subpart J of 39 C.F.R. Part 3010—Workshare Discounts

Section 3010.280, Applicability. This subpart establishes rate design criteria for workshare discounts. The rate design criteria for workshare discounts apply any time a rate that is associated with a workshare discount is adjusted (*i.e.*, for adjustment of Market Dominant rates of general applicability subject to the maximum rate adjustment authority governing those rate increases and rate adjustments due to extraordinary and exceptional circumstances). Unless otherwise provided by the Commission, the cost avoided by the Postal Service for not providing the applicable service represents the amount identified in the most recent ACD.

Section 3010.281, Calculation of passthroughs for workshare discounts. The percentage passed through is defined as the workshare discount offered by the Postal

Service divided by the cost avoided by the Postal Service for not providing the applicable service.

Section 3010.282, Increased pricing efficiency. This section codifies the “Do No Harm” principle. Proposed § 3010.282(a) prohibits changes to a workshare discount that already equals the cost avoided by the Postal Service for not providing the applicable service. Proposed § 3010.282(b) prohibits increases to a workshare discount that already exceeds the avoided cost. Proposed § 3010.282(c) prohibits decreases to a workshare discount that already falls short of the avoided cost.

Section 3010.283, Limitations on excessive discounts. This section sets forth the four limited instances in which the Postal Service may propose to set a workshare discount in excess of its avoided costs.

Proposed § 3010.283(b) permits a new workshare discount to exceed the avoided cost. The Commission construes this provision strictly. After the applicable workshare discount is no longer new, the workshare discount must be set equal to its avoided costs or must comply with one of the other provisions for setting the workshare discount above its avoided costs.

Proposed § 3010.283(c) permits an excessive workshare discount that represents a decrease of at least 20 percent as compared to the corresponding existing workshare discount.

Proposed § 3010.283(d) permits a workshare discount to exceed the avoided cost, if the Commission has granted an application for waiver. For instance, in rare circumstances where the Postal Service believes that a category of mailers or operations would be severely harmed by a 20-percent change in the discount and none of the other circumstances of proposed § 3010.283 would apply, the Postal Service may request a waiver.

Proposed § 3010.283(e) permits a workshare discount to exceed the avoided cost if the subclass of mail at issue consists exclusively of mail matter of ECSI value and the Postal Service provides the information required under proposed § 3010.285(c).

Section 3010.284, Limitations on discounts below avoided cost. Similar to requests for excessive workshare discounts, proposed § 3010.284 sets forth four limited instances in which the Postal Service may set workshare discounts below avoided costs. Many of these scenarios mirror those described in proposed § 3010.283.

Proposed § 3010.284(b) permits a new workshare discount below the avoided cost. Similar to proposed § 3010.283(b), the Commission construes this provision strictly. After the applicable workshare discount is no longer new, the workshare discount must be set equal to its avoided costs or must comply with one of the other provisions for setting the workshare discount below its avoided costs.

Proposed § 3010.284(c) permits a low workshare discount that represents an increase of at least 20 percent as compared to the corresponding existing workshare discount.

Proposed § 3010.284(d) permits a workshare discount below the avoided cost, if the Commission has granted an application for waiver.

Proposed § 3010.284(e) permits a workshare discount below the avoided cost, if the proposed passthrough would be at least 85 percent.

Section 3010.285, Proposal to adjust a rate associated with a workshare discount. Proposed § 3010.285 outlines the workshare discount information the Postal Service must include as part of a rate adjustment filing.

Proposed § 3010.285(a) requires the proposal to adjust a workshare discount rate to be supported by substantial evidence and demonstrate compliance with the

applicable provisions appearing in 39 U.S.C. § 3622(e) and proposed subpart J of 39 C.F.R. part 3010. For each proposed excessive workshare discount, proposed § 3010.285(b) requires the rate adjustment filing to specify which provision(s) of proposed § 3010.283 would apply and provide any relevant supporting analysis. Commensurately, for each workshare discount proposed to be set below its avoided cost, proposed § 3010.285(d) requires the rate adjustment filing to specify which provision(s) of proposed § 3010.284 would apply and provide any relevant supporting analysis.

For each proposed excessive workshare discount provided in connection with a subclass of mail that consists exclusively of mail matter of ECSI value, proposed § 3010.285(c) requires additional information to be provided. This information is not required if the excessive workshare discount at issue is new, decreased by at least 20 percent, or set in accordance with a Commission order granting an application for waiver.

Section 3010.286, Application for waiver. This section sets forth the requirements for when the Postal Service applies for waiver from proposed §§ 3010.283 through 3010.284.

Proposed § 3010.286(a) requires that an application be filed at least 60 days before the rate adjustment filing. The Postal Service should consider the nature and complexity of each application for waiver and provide the Commission with ample time to analyze the waiver request and make a determination in advance of the Postal Service's next rate adjustment filing.

Proposed § 3010.286(b) requires that the application be supported by a preponderance of the evidence and defines this standard. This is a more rigorous standard than the Commission has applied to similar claims by the Postal Service in the past.

Proposed § 3010.286(c) sets forth the required contents of an application. The analysis included in the application would need to be fully developed and specific to the particular workshare discount for which waiver is requested.

Proposed § 3010.286(c)(1) and (2) require that each application must adequately support the reasons why and length of time that waiver is alleged to be needed. Proposed § 3010.286(c)(3) requires that each application describe the minimum amount of improvement expected for the workshare discount in each subsequent request for rate adjustment that will occur during the waiver period.

Proposed § 3010.286(c)(4) through (7) set forth the requirements specific to an application for waiver based on claims of rate shock, operational efficiency, and a loss of volume and reduction of the aggregate contribution to institutional costs, or a further decrease in rates paid by mailers not able to take advantage of the discount.

Proposed § 3010.286(c)(4) itemizes three specific content requirements for an application based on a claim of rate shock. First, the Postal Service must identify the group of mailers that would be adversely affected by the reduction of the excessive discount. Generally, to reduce a discount, the Postal Service does not have to raise prices on any specific group of mailers. The Postal Service may reduce the benchmark rate, thereby shrinking the difference between the benchmark and the workshared category rate. In most cases, the Commission expects that the only group of mailers that would be adversely affected by the reduction of the excessive discount would consist of the mailers that use the discount. However, the Commission acknowledges that special circumstances may exist such that the Postal Service can only reduce an excessive workshare discount by increasing the price of the workshared category rate. In such a case, the users of the workshared category rate could be considered the group that would be adversely impacted by reducing the discount.

Second, the Postal Service must provide prices and mail volumes for the benchmark and workshared categories related to the discount for the last 10 years. Rate and volume history are necessary to provide context for the Postal Service's claim of rate shock.

Third, the Postal Service must identify the likely harm that may come to customers who use the discount or related rate categories. The Postal Service must include supporting information including a quantitative analysis demonstrating the harm that the required 20 percent change to the discount is likely to cause and, if such quantitative analysis is not available, a qualitative description of the likely harm is permitted. The Postal Service should include any relevant information including the sensitivity of the affected mailers to price changes. Additionally, the Postal Service should provide information on other discounts or rates used by the affected mailers, and estimate the cumulative effect of all changes to workshare discounts and prices utilized by the affected mailers. In evaluating the likelihood of rate shock, the Commission will consider whether the discount is applicable to a relatively small or large portion of the mail that a mailer tenders.

Proposed § 3010.286(c)(5) itemizes three specific content requirements for an application based on a claim that setting the workshare discount closer or equal to the costs avoided would impede efficient operation of the Postal Service. Such waiver may be requested for both excessive workshare discounts (pursuant to 39 U.S.C. § 3622(e)(2)(D)) or workshare discounts below avoided costs. The application must describe the operational strategy at issue, provide quantitative or qualitative analysis explaining how the workshare discount at issue is related to that operational strategy, and explain how and why setting the workshare discount closer to its avoided costs by at least 20 percent would impede that operational strategy.

Proposed § 3010.286(c)(6) and (7) itemize three specific content requirements for an application based on a claim that either limitation would apply. Proposed

§ 3010.286(c)(6) requires that an application based on 39 U.S.C. § 3622(e)(3)(A) must describe the affected mail category, provide quantitative or qualitative analysis indicating the expected loss of volume and reduced contribution that would result, and how reducing the excessive workshare discount by at least 20 percent would lead to the expected loss of volume and reduced contribution. Proposed § 3010.286(c)(7) requires that an application based on 39 U.S.C. § 3622(e)(3)(B) must describe the mailers who are not able to take advantage of the discount, provide quantitative or qualitative analysis indicating the expected size of the rate increase that is claimed would result in the rates paid by mailers not able to take advantage of the discount, and explain how reducing the excessive workshare discount by at least 20 percent would result in a further increase in the rates paid by mailers not able to take advantage of the discount. Proposed § 3010.286(c)(6) and (7) would not alter the Commission's long-standing views on the use of the limitations appearing in 39 U.S.C. § 3622(e)(3)(A) and (B).³³⁴

Proposed § 3010.286(c)(8) notifies the Postal Service that it must provide any other relevant information to support its application for waiver.

Proposed § 3010.286(d) allows at least 7 calendar days after filing the application for public comment.

Proposed § 3010.286(e) notifies the public that the Commission may require the Postal Service to provide additional supporting technical information. This provision is intended only to provide an opportunity to develop additional information as needed to better evaluate the application and not to cure any potential defect contained therein. The Commission expects that the Postal Service's application would substantially comply with the applicable content requirements and support its claim that a waiver is needed by a preponderance of the evidence.

³³⁴ See Docket No. ACR2009, *Annual Compliance Determination*, March 29, 2010, at 69.

Proposed § 3010.286(f) states that an application proposing to set a workshare discount higher than avoided cost may be granted only if at least one provision appearing in 39 U.S.C. § 3622(e)(2)(A) through (D) or (e)(3)(A) through (B) would apply.

Proposed § 3010.286(g) states that an application proposing to set a workshare discount lower than avoided cost may be granted only to prevent an impediment to operational strategy.

Proposed § 3010.286(h) provides that the Commission ruling on the application will be issued within 21 days after reply comments and that an order granting an application will specify all conditions, including its expiration date.

XII. SECTION-BY-SECTION ANALYSIS OF THE PROPOSED CHANGES TO 39 C.F.R. PART 3020, AS REVISED

A. Proposed Conforming Changes to Supporting Justifications and Comment Opportunity

To improve global consistency between 39 C.F.R. part 3020 and 39 C.F.R. part 3010, conforming changes are made to the requirements for the supporting justification for a request by the Postal Service or a user of the mail to modify the product list and a proposal by the Commission to modify the product list.

Section 3020.32, Supporting justification. Proposed § 3020.32(a) modifies the existing text to reflect that the supporting justification for a request by the Postal Service to modify the product lists shall explain the reason for initiating the docket and why the change is not inconsistent with the applicable requirements of requirements of 39 C.F.R. part 3020, and any applicable Commission directives and orders. Proposed § 3020.32(b) modifies the existing text to reflect that the supporting justification shall explain why a change affecting Market Dominant products, is not inconsistent with the applicable policies and criteria of 39 U.S.C. chapter 36.

Section 3020.52, Supporting justification. Proposed § 3020.52(a) modifies the existing text to reflect that the supporting justification for a request by a user of the mail to modify the product lists shall explain the reason for initiating the docket and why the change is not inconsistent with the applicable requirements of requirements of 39 C.F.R. part 3020, and any applicable Commission directives and orders. Proposed § 3020.52(b) modifies the existing text to reflect that the supporting justification shall explain why a change affecting Market Dominant products, is not inconsistent with the applicable policies and criteria of 39 U.S.C. chapter 36.

Section 3020.72, Supporting justification. Proposed § 3020.72(a) modifies the existing text to reflect that the supporting justification for a proposal by the Commission to modify the product lists shall explain the reason for initiating the docket and why the

change is not inconsistent with the applicable requirements of requirements of 39 C.F.R. part 3020, and any applicable Commission directives and orders. Proposed § 3020.72(b) modifies the existing text to reflect that the supporting justification shall explain why a change affecting Market Dominant products, is not inconsistent with the applicable policies and criteria of 39 U.S.C. chapter 36.

Conforming changes are also made to improve consistency between the existing requirements for the explanations provided by the Postal Service concerning proposals to make material changes or minor corrections to product descriptions, as compared to the corresponding opportunity for comment.

Section 3020.81, Supporting justification for material changes to product descriptions. Proposed § 3020.81(b)(1) modifies the existing text to reflect that the supporting justification for a proposal by the Postal Service to materially change product descriptions shall explain why the change is not inconsistent with the applicable policies and criteria of 39 U.S.C. chapter 36, the applicable requirements of requirements of 39 C.F.R. part 3020, and any applicable Commission directives and orders.

Section 3020.82, Docket and notice of material changes to product descriptions. Proposed § 3020.82(e) modifies the existing text to reflect that an opportunity for the public to comment will be provided concerning consistency of the proposed change with the applicable policies and criteria of 39 U.S.C. chapter 36, the applicable requirements of requirements of 39 C.F.R. part 3020, and any applicable Commission directives and orders.

Section 3020.90, Minor corrections to product descriptions. Proposed § 3020.90(c)(2) modifies the existing text to reflect that the Postal Service's notice of minor corrections to product descriptions shall explain why the proposed correction is not inconsistent with the applicable policies and criteria of 39 U.S.C. chapter 36, the applicable requirements of requirements of 39 C.F.R. part 3020, and any applicable Commission directives and orders.

Section 3020.91, Docket and notice of minor corrections to product descriptions.

Proposed § 3020.91(e) modifies the existing text to reflect that an opportunity for the public to comment will be provided concerning consistency of the proposed correction with the applicable policies and criteria of 39 U.S.C. chapter 36, the applicable requirements of requirements of 39 C.F.R. part 3020, and any applicable Commission directives and orders.

B. Proposed Subpart G of 39 C.F.R. Part 3020—Requests for Market Dominant Negotiated Service Agreements

Whenever a new NSA is proposed, a primary consideration is whether the agreement is properly classified as either Market Dominant or Competitive. The starting point for considering the proper classification is the existing rules appearing in 39 C.F.R. part 3020. Those rules govern the MCS and the addition, deletion, or transfer of a product to either the Market Dominant product list or the Competitive product list. The rules currently appearing in 39 C.F.R. part 3010, subpart D generally assist in the analysis required by existing 39 C.F.R. part 3020. The remainder of the rules governing the regulation of rates appearing in existing 39 C.F.R. part 3010 are generally not implicated. Thus, the rules currently appearing in existing 39 C.F.R. part 3010, subpart D, concerning NSAs, are moved to proposed 39 C.F.R. part 3020, subpart G.

In several instances, the rules currently appearing in 39 C.F.R. part 3010, subpart D are duplicative of the rules appearing in existing 39 C.F.R. part 3020. Moving these provisions allows for streamlining of the rules. There is no intent to change the meaning or operation of the rules currently in place. The move should clarify that a proposal to add a new NSA is to be filed pursuant to 39 C.F.R. part 3020. Furthermore, in most instances, adjustments to rates for existing NSAs require a review of the material previously provided pursuant to 39 C.F.R. part 3020. Again, the rules governing the regulation of rates appearing in 39 C.F.R. part 3010 are generally not

implicated. Thus, requests concerning the adjustment of rates for NSAs should be filed as a contract update pursuant to 39 C.F.R. part 3020.

Existing § 3010.40, Negotiated service agreements. This rule merely repeats the statutory requirements of 39 U.S.C. § 3622(c)(10) and is being deleted. This statutory requirement is effectively analyzed using the supporting material that will be provided under proposed § 3020.121.

Existing § 3010.41, Notice. This rule is duplicative of the notice requirements appearing in existing 39 C.F.R. part 3020 applicable to new NSAs and is being deleted.

Existing § 3010.44, Proceedings for type 2 rate adjustments. Paragraph (a) of existing § 3010.44 is duplicative of the docketing and notice requirements currently appearing in 39 C.F.R. part 3020 applicable to new NSAs and is being deleted. The requirements appearing in existing § 3010.44(b) and (c) are being incorporated into the general requirements of proposed § 3020.120.

Section 3020.120, General. This rule explains that the requirements of 39 C.F.R. part 3020, subpart G, which are specific to Market Dominant NSAs, impose requirements in addition to those appearing elsewhere in 39 C.F.R. part 3020, which are applicable to adding products to a product list. It also incorporates the existing requirements currently appearing in existing § 3010.44(b) and (c) as discussed above.³³⁵

Section 3020.121, Additional supporting justification for negotiated service agreements. Proposed § 3020.121 combines the requirements for additional supporting information, which appears in existing § 3010.42, with the requirement for the

³³⁵ Note that there is a requirement for the Postal Service to provide at least a 45-day notice whenever it adds, removes, or adjusts a rate applicable to an NSA. There is no similar statutory requirement governing the Commission's time for consideration of the addition, removal, or transfer of an NSA to a product list.

availability of similar NSAs to similarly situated mailers, which appears in existing § 3010.40(c). The requirement to produce evidence that the Postal Service has provided notice at least 45 days before a new rate can go into effect, which appears in existing § 3010.42(c), has been deleted.

Section 3020.122, Data collection plan and report for negotiated service agreements. Proposed § 3020.122 incorporates the rules concerning a data collection plan, which appear in existing § 3010.43.

XIII. SECTION-BY-SECTION ANALYSIS OF THE PROPOSED CHANGES TO 39 C.F.R. PART 3050, AS REVISED

Section 3050.20, Compliance and other analyses in the Postal Service's section 3652 report. This Order does not alter the initial proposal to strike the phrase “discounts greater than avoided costs” appearing in existing § 3050.20(c). See Order No. 4258 at 129. The provision applicable to workshare discounts, which appears in existing § 3050.20(c) has been superseded by the provisions of proposed 39 C.F.R. part 3010, Subpart J—Workshare Discounts and proposed § 3050.21(e).

Section 3050.21, Content of the Postal Service's section 3652 report. New requirements are proposed concerning provision of information related to workshare discounts, TFP, and the annual determinations made by OPM of the amounts of the supplemental and unfunded liabilities for the statutorily mandated retirement obligations.

Existing § 3050.21(e) sets forth the required reporting for each Market Dominant workshare discount offered during the fiscal year under review. No changes are proposed to existing § 3050.21(e)(1) through (e)(2). However, changes are proposed to existing § 3050.21(e)(3) through (e)(4) and a new requirement is added as proposed § 3050.21(e)(5).

Proposed § 3050.21(e)(5) requires the Postal Service to provide information specific to certain excessive workshare discounts justified pursuant to 39 U.S.C. § 3622(e)(2)(C). The conditions for, and content of, this reporting are the same as proposed § 3010.284(c). Conforming edits to reflect the addition of this new reporting requirement appear in existing § 3050.21(e)(3) through (e)(4). Additional clarifying edits are proposed to existing § 3050.21(e)(4) to cross-reference the provisions appearing in 39 U.S.C. § 3622(e)(3)(A) through (B).

Two new reporting requirements related to two of the additional forms of rate adjustment authority are added to this section. In connection with the performance-based rate authority, which is dependent on the Postal Service exceeding an

operational efficiency-based requirement, proposed § 3050.21(m) requires the provision of the input data and calculations used to produce the annual TFP estimates. In connection with the retirement obligation rate authority, which is based on the amortization of the amounts of the supplemental and unfunded liabilities for the statutorily mandated retirement obligations, proposed § 3050.21(n) requires the provision of the copies of OPM notifications provided to the Postal Service of the annual determinations of the applicable amounts. Conforming edits to reflect the addition of these new reporting requirements also appear in existing § 3050.21(a) and (l) and proposed § 3050.21(o).

Section 3050.55, Information pertaining to cost reduction initiatives. This new rule requires the Postal Service to provide a report related to its cost reduction initiatives within 95 days after the end of each fiscal year. Proposed § 3050.55(b)(1) through (5) require the provision of certain cost data, either specific to the fiscal year under review or isolating the percentage change occurring in the fiscal year under review relative to the previous fiscal year. Proposed § 3050.55(b)(6) requires the provision of additional explanatory material if the percentage change in unit attributable cost for a Market Dominant mail product is more than 0.0 percent, and exceeds the percentage change in total Market Dominant mail unit attributable cost. Proposed § 3050.55(b)(7) requires the Postal Service to provide an analysis of volume trends and mail mix changes for each Market Dominant mail product compared to fiscal year 2017, and sets forth the minimum elements of such analysis. For planned cost reduction initiatives that are expected to incur expenditures of at least \$5 million, proposed § 3050.55(c) requires the Postal Service to provide information concerning the initiative, the metric selected to measure the cost-reduction impact of the initiative, and the estimated cost-reduction impact. For active cost reduction initiatives that are expected to incur expenditures of at least \$5 million, proposed § 3050.55(d) requires the Postal Service to compare planned versus actual impact and explain any variance and revisions to the Postal Service's plans. For ongoing and planned projects that are associated with a DAR (expected to

incur expenditures of at least \$1 million), proposed § 3050.55(d) and (e) require the Postal Service to provide general information concerning the project, its status, estimated cost savings or additional revenues, and estimated return on investment.

Section 3050.60, Miscellaneous reports and documents. Because proposed § 3050.21(m) modifies the date for which the input data and calculations used to produce the annual TFP estimates is due, existing § 3050.60(e) is deleted. To reflect this deletion: the cross-reference appearing in existing § 3050.60(a) is modified and existing § 3050.60(f) and (g) are redesignated as proposed paragraphs (e) and (f), respectively.

XIV. SECTION-BY-SECTION ANALYSIS OF THE PROPOSED CHANGES TO 39
C.F.R. PART 3055, AS REVISED

Section 3055.2, Contents of the annual report of service performance achievements. Existing § 3055.2(c) requires the reporting of the applicable service standard(s) for each product. This paragraph is expanded to require the Postal Service to also provide a description of and reason for any changes to service standards, or to certify that no changes to service standards have been made, since the last report.

XV. ADMINISTRATIVE ACTIONS

The Commission will accept comments and reply comments on the proposed changes outlined by this rulemaking. Comments are due no later than February 3, 2020. Reply comments are due no later than March 4, 2020. Pursuant to 39 U.S.C. § 505, Richard A. Oliver continues to be designated as an officer of the Commission (Public Representative) to represent the interests of the general public in this proceeding. See Order No. 3673 at 11.

Commission rules require that comments (including reply comments) be filed online according to the process outlined at 39 C.F.R. § 3001.9(a), unless a waiver is obtained. Additional information regarding how to submit comments online can be found at: <http://www.prc.gov/how-to-participate>. All comments accepted will be made available on the Commission's website (<http://www.prc.gov>).

The Regulatory Flexibility Act requires federal agencies, in promulgating rules, to consider the impact of those rules on small entities. See 5 U.S.C. §§ 601, *et seq.* If the proposed or final rules will not, if promulgated, have a significant economic impact on a substantial number of small entities, the head of the agency may certify that the initial and final regulatory flexibility analysis requirements of 5 U.S.C. §§ 603 and 604 do not apply. See 5 U.S.C. § 605(b). In the context of this rulemaking, the Commission's primary responsibility is in the regulatory oversight of the United States Postal Service. The rules that are the subject of this rulemaking have a regulatory impact on the Postal Service, but do not impose any regulatory obligation upon any other entity. Based on these findings, the Chairman of the Commission certifies that the rules that are the subject of this rulemaking will not have a significant economic impact on a substantial number of small entities. Therefore, pursuant to 5 U.S.C. § 605(b), this rulemaking is exempt from the initial and final regulatory flexibility analysis requirements of 5 U.S.C. §§ 603 and 604.

XVI. ORDERING PARAGRAPHS

It is ordered:

1. Attached with this Notice and Order are three reports referenced therein.³³⁶
2. Pursuant to 39 U.S.C. § 505, Richard A. Oliver shall continue to serve as an officer of the Commission (Public Representative) to represent the interests of the general public in this proceeding.
3. Comments regarding the proposed rulemaking are due no later than February 3, 2020.
4. Reply comments regarding the proposed rulemaking are due no later than March 4, 2020.
5. The Secretary shall arrange for publication of the revised proposed rules and general statement as to the basis and purpose of the revised proposed rules in the *Federal Register*.

By the Commission.

Darcie S. Tokioka
Acting Secretary

³³⁶ See Section III.C.2. at 34; Section V.C.3. at 132-133; Section V.C.4. at 141-142, *supra*.

List of Subjects

39 CFR Part 3010

Administrative practice and procedure, Postal Service.

39 CFR Part 3020

Administrative practice and procedure.

39 CFR Part 3050

Administrative practice and procedure, Postal Service, Reporting and recordkeeping requirements.

39 CFR Part 3055

Administrative practice and procedure, Reporting and recordkeeping requirements.

For the reasons discussed in the preamble, the Commission proposes to amend Chapter III of title 39 of the Code of Federal Regulations as follows:

1. Revise part 3010 to read as follows:

PART 3010—REGULATION OF RATES FOR MARKET DOMINANT PRODUCTS

Subpart A—General Provisions

Sec.

3010.100 Applicability.

3010.101 Definitions.

3010.102 Schedule for regular and predictable rate adjustments.

Subpart B—Rate Adjustments

3010.120 General.

3010.121 Postal Service rate adjustment filing.

- 3010.122 Contents of a rate adjustment filing.
- 3010.123 Supporting technical documentation.
- 3010.124 Docket and notice.
- 3010.125 Opportunity for comments.
- 3010.126 Proceedings.
- 3010.127 Maximum rate adjustment authority.
- 3010.128 Calculation of percentage change in rates.
- 3010.129 Exceptions for de minimis rate increases.

Subpart C—Consumer Price Index Rate Authority

- 3010.140 Applicability.
- 3010.141 CPI-U data source.
- 3010.142 CPI-U rate authority when rate adjustment filings are 12 or more months apart.
- 3010.143 CPI-U rate authority when rate adjustment filings are less than 12 months apart.

Subpart D—Density Rate Authority

- 3010.160 Applicability.
- 3010.161 Density calculation data sources.
- 3010.162 Calculation of density rate authority.

Subpart E—Retirement Obligation Rate Authority

- 3010.180 Definitions.
- 3010.181 Applicability.
- 3010.182 Retirement obligation data sources.
- 3010.183 Calculation of retirement obligation rate authority.
- 3010.184 Required minimum remittances.
- 3010.185 Forfeiture.

Subpart F—Performance-based Rate Authority

- 3010.200 Applicability.
- 3010.201 Operational efficiency-based requirement.
- 3010.202 Service quality-based requirement.

Subpart G—Non-compensatory Classes or Products

- 3010.220 Applicability.
- 3010.221 Individual product requirement.
- 3010.222 Class requirement and additional class rate authority.

Subpart H—Accumulation of Unused and Disbursement of Banked Rate Adjustment Authority

- 3010.240 General.

- 3010.241 Schedule of banked rate adjustment authority.
- 3010.242 Calculation of unused rate adjustment authority for rate adjustments that involve a rate increase which are filed 12 months apart or less.
- 3010.243 Calculation of unused rate adjustment authority for rate adjustments that involve a rate increase which are filed more than 12 months apart.
- 3010.244 Calculation of unused rate adjustment authority for rate adjustments that only include rate decreases.
- 3010.245 Application of banked rate authority.

Subpart I—Rate Adjustments Due to Extraordinary and Exceptional Circumstances

- 3010.260 General.
- 3010.261 Contents of a rate adjustment filing.
- 3010.262 Supplemental information.
- 3010.263 Docket and notice.
- 3010.264 Public hearing.
- 3010.265 Opportunity for comments.
- 3010.266 Deadline for Commission decision.
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Authority: 39 U.S.C. 503; 3622.

Subpart A—General Provisions.

§ 3010.100 Applicability.

(a) The rules in this part implement provisions in 39 U.S.C. chapter 36, subchapter I, establishing the modern system of ratemaking for regulating rates and classes for market dominant products. These rules are applicable whenever the Postal Service proposes to adjust a rate of general applicability for any market dominant

product, which includes the addition of a new rate, the removal of an existing rate, or a change to an existing rate. Current rates may be found in the Mail Classification Schedule appearing on the Commission's website at *www.prc.gov*.

(b) Rates may be adjusted either subject to the rules appearing in subpart B of this part, which includes a limitation on rate increases, or subject to the rules appearing in subpart I of this part, which does not include a limitation on rate increases but requires either extraordinary or exceptional circumstances. The rules applicable to the calculation of the limitations on rate increases appear in subparts C through H of this part. The rules for workshare discounts, which are applicable whenever market dominant rates are adjusted, appear in subpart J of this part.

§ 3010.101 Definitions.

(a) The definitions in paragraphs (b) through (m) of this section apply to this part.

(b) "Annual limitation" means the annual limitation on the percentage change in rates equal to the change in the Consumer Price Index for all Urban Consumers (CPI-U) unadjusted for seasonal variation over the most recently available 12-month period preceding the date the Postal Service files a request to review its notice of rate adjustment, as determined by the Commission.

(c) "Banked rate authority" means unused rate adjustment authority accumulated for future use pursuant to these rules.

(d) A "class" of mail means the First-Class Mail, USPS Marketing Mail, Periodicals, Package Services, or Special Services groupings of market dominant

Postal Service products or services. Generally, the regulations in this part are applicable to individual classes of mail.

(e) “Density rate authority” means rate authority that is available to all classes to address the effects of decreases in density of mail.

(f) “Maximum rate adjustment authority” means the maximum percentage change in rates available to a class for any planned increase in rates. It is the sum of: the consumer price index rate authority, and any available density rate authority, retirement obligation rate authority, banked rate authority, performance-based rate authority, and rate authority applicable to non-compensatory classes.

(g) “Performance-based rate authority” means rate authority that is available to all classes where the Postal Service meets or exceeds operational efficiency-based requirement and adheres to service standard-based requirement as determined by the Commission.

(h) “Rate authority applicable to non-compensatory classes” means rate authority available to classes where revenue for each product within the class was insufficient to cover that product’s attributable costs as determined by the Commission.

(i) “Rate cell” means each and every separate rate identified as a rate of general applicability.

(j) “Rate incentive” means a discount that is not a workshare discount and that is designed to increase or retain volume, improve the value of mail for mailers, or improve the operations of the Postal Service.

(k) “Rate of general applicability” means a rate applicable to all mail meeting standards established by the Mail Classification Schedule, the Domestic Mail Manual, and the International Mail Manual. A rate is not a rate of general applicability if eligibility for the rate is dependent on factors other than the characteristics of the mail to which the rate applies. A rate is not a rate of general applicability if it benefits a single mailer. A rate that is only available upon the written agreement of both the Postal Service and a mailer, a group of mailers, or a foreign postal operator is not a rate of general applicability.

(l) “Retirement obligation rate authority” means rate authority that is available to all classes to provide revenue for remittance towards the statutorily mandated amortization payments for unfunded liabilities.

(m) A “seasonal or temporary rate” is a rate that is in effect for a limited and defined period of time.

§ 3010.102 Schedule for regular and predictable rate adjustments.

(a) The Postal Service shall develop a Schedule for Regular and Predictable Rate Adjustments applicable to rate adjustments subject to this part. The Schedule for Regular and Predictable Rate Adjustments shall:

- (1) Schedule rate adjustments at specific regular intervals of time;
- (2) Provide estimated filing and implementation dates (month and year) for future rate adjustments for each class of mail expected over a minimum of the next 3 years; and

(3) Provide an explanation that will allow mailers to predict with reasonable accuracy, by class, the amounts of future scheduled rate adjustments.

(b) The Postal Service shall file a current Schedule for Regular and Predictable Rate Adjustments annually with the Commission at the time of filing the Postal Service's section 3652 report. The Commission shall post the current schedule on the Commission's website at *www.prc.gov*.

(c) Whenever the Postal Service deems it appropriate to change the Schedule for Regular and Predictable Rate Adjustments, it shall file a revised schedule.

(d) The Postal Service may vary the magnitude of rate adjustments from those estimated by the Schedule for Regular and Predictable Rate Adjustments. In such case, the Postal Service shall provide an explanation for such variation with its rate adjustment filing.

Subpart B—Rate Adjustments

§ 3010.120 General

This subpart describes the process for the periodic adjustment of rates subject to the percentage limitations specified in § 3010.127 that are applicable to each class of mail.

§ 3010.121 Postal Service rate adjustment filing.

(a) In every instance in which the Postal Service determines to exercise its statutory authority to adjust rates for a class of mail, the Postal Service shall comply with the requirements specified in paragraphs (b) through (d) of this section.

(b) The Postal Service shall take into consideration how the planned rate adjustments are in accordance with the provisions of 39 U.S.C. chapter 36.

(c) The Postal Service shall provide public notice of its planned rate adjustments in a manner reasonably designed to inform the mailing community and the general public that it intends to adjust rates no later than 90 days prior to the planned implementation date of the rate adjustments.

(d) The Postal Service shall file a request to review its notice of rate adjustment with the Commission no later than 90 days prior to the planned implementation date of the rate adjustment.

§ 3010.122 Contents of a rate adjustment filing.

(a) A rate adjustment filing under § 3010.121 shall include the items specified in paragraphs (b) through (j) of this section.

(b) A representation or evidence that public notice of the planned changes has been issued or will be issued at least 90 days before the effective date(s) for the planned rate adjustments.

(c) The intended effective date(s) of the planned rate adjustments.

(d) A schedule of the planned rate adjustments, including a schedule identifying every change to the Mail Classification Schedule that will be necessary to implement the planned rate adjustments.

(e) The identity of a responsible Postal Service official who will be available to provide prompt responses to requests for clarification from the Commission.

(f) The supporting technical documentation as described in § 3010.123.

(g) A demonstration that the planned rate adjustments are consistent with 39 U.S.C. 3626, 3627, and 3629.

(h) A certification that all cost, avoided cost, volume, and revenue figures submitted with the rate adjustment filing are developed from the most recent applicable Commission accepted analytical principles.

(i) For a rate adjustment that only includes a decrease in rates, a statement of whether the Postal Service elects to generate unused rate adjustment authority.

(j) Such other information as the Postal Service believes will assist the Commission in issuing a timely determination of whether the planned rate adjustments are consistent with applicable statutory policies.

§ 3010.123 Supporting technical documentation.

(a) Supporting technical documentation shall include the items specified in paragraphs (b) through (k) of this section, as applicable to the specific rate adjustment filing. This information must be supported by workpapers in which all calculations are shown and all relevant values (*e.g.*, rates, CPI-U values, billing determinants) are identified with citations to original sources. The information must be submitted in machine-readable, electronic format. Spreadsheet cells must be linked to underlying data sources or calculations (not hard-coded), as appropriate.

(b) The maximum rate adjustment authority, by class, as summarized by § 3010.127 and calculated separately for each of subparts C through H of this part, as appropriate.

(c) A schedule showing the banked rate adjustment authority available, by class, and the available amount for each of the preceding 5 years calculated as required by subpart H of this part.

(d) The calculation of the percentage change in rates, by class, calculated as required by § 3010.128.

(e) The planned usage of rate adjustment authority, by class, and calculated separately for each of subparts C through H of this part, as appropriate.

(f) The amount of new unused rate adjustment authority, by class, if any, that will be generated by the rate adjustment calculated as required by subpart H of this part, as applicable.

(g) A schedule of the workshare discounts included with the planned rate adjustments, and a companion schedule listing the avoided costs that underlie each such discount.

(h) Whenever the Postal Service establishes a new workshare discount rate, it must include with its filing:

(1) A statement explaining its reasons for establishing the workshare discount;

(2) All data, economic analyses, and other information relied on to justify the workshare discount; and

(3) A certification based on comprehensive, competent analyses that the discount will not adversely affect either the rates or the service levels of users of postal services who do not take advantage of the workshare discount.

(i) Whenever the Postal Service establishes a new discount or surcharge rate it does not view as creating a workshare discount, it must include with its filing:

(1) An explanation of the basis for its view that the discount or surcharge rate is not a workshare discount; and

(2) A certification that the Postal Service applied accepted analytical principles to the discount or surcharge rate.

(j) Whenever the Postal Service includes a rate incentive with its planned rate adjustment, it must include with its filing:

(1) If the rate incentive is a rate of general applicability, sufficient information to demonstrate that the rate incentive is a rate of general applicability; and

(2) A statement of whether the Postal Service has excluded the rate incentive from the calculation of the percentage change in rates under § 3010.128.

(k) For each class or product where the attributable cost for that class or product exceeded the revenue from that class or product as determined by the Commission, a demonstration that the planned rate adjustments comply with the requirements in subpart G of this part.

§ 3010.124 Docket and notice.

(a) The Commission will establish a docket for each rate adjustment filed by the Postal Service under § 3010.121, promptly publish notice of the filing in the **Federal Register**, and post the filing on its website. The notice shall include the items specified in paragraphs (b) through (g) of this section.

(b) The general nature of the proceeding.

(c) A reference to legal authority under which the proceeding is to be conducted.

(d) A concise description of the planned changes in rates, fees, and the Mail Classification Schedule.

(e) The identification of an officer of the Commission to represent the interests of the general public in the docket.

(f) A period of 30 days from the date of the filing for public comment.

(g) Such other information as the Commission deems appropriate.

§ 3010.125 Opportunity for comments.

Public comments should focus on whether planned rate adjustments comport with applicable statutory and regulatory requirements.

§ 3010.126 Proceedings.

(a) If the Commission determines that the rate adjustment filing does not substantially comply with the requirements of §§ 3010.122 and 3010.123, the Commission may:

(1) Inform the Postal Service of the deficiencies and provide an opportunity for the Postal Service to take corrective action;

(2) Toll or otherwise modify the procedural schedule until such time the Postal Service takes corrective action;

(3) Dismiss the rate adjustment filing without prejudice; or

(4) Take other action as deemed appropriate by the Commission.

(b) Within 21 days of the conclusion of the public comment period the Commission will determine whether the planned rate adjustments are consistent with

applicable law and issue an order announcing its findings. Applicable law means only the applicable requirements of this part, Commission directives and orders, and 39 U.S.C. 3626, 3627, and 3629.

(c) If the planned rate adjustments are found consistent with applicable law, they may take effect.

(d) If the planned rate adjustments are found inconsistent with applicable law, the Commission will notify and require the Postal Service to respond to any issues of noncompliance.

(e) Following the Commission's notice of noncompliance, the Postal Service may submit an amended rate adjustment filing that describes the modifications to its planned rate adjustments that will bring its rate adjustments into compliance. An amended rate adjustment filing shall be accompanied by sufficient explanatory information to show that all deficiencies identified by the Commission have been corrected.

(f) The Commission will allow a period of 10 days from the date of the amended rate adjustment filing for public comment.

(g) The Commission will review the amended rate adjustment filing together with any comments filed for compliance and issue an order announcing its findings within 21 days after the comment period ends.

(h) If the planned rate adjustments as amended are found to be consistent with applicable law, they may take effect. However, no amended rate shall take effect until 45 days after the Postal Service transmits its rate adjustment filing specifying that rate.

(i) If the planned rate adjustments in an amended rate adjustment filing are found to be inconsistent with applicable law, the Commission shall explain the basis for its determination and suggest an appropriate remedy. Noncompliant rates may not go into effect.

(j) A Commission finding that a planned rate adjustment is in compliance with the applicable requirements of this part, Commission directives and orders, and 39 U.S.C. 3626, 3627, and 3629 is decided on the merits. A Commission finding that a planned rate adjustment does not contravene other policies of 39 U.S.C. chapter 36, subchapter I is provisional and subject to subsequent review.

§ 3010.127 Maximum rate adjustment authority.

(a) The maximum rate adjustment authority available to the Postal Service for each class of market dominant mail is limited to the sum of the percentage points developed in:

- (1) Subpart C—Consumer Price Index Rate Authority;
- (2) Subpart D—Density Rate Authority;
- (3) Subpart E—Retirement Obligation Rate Authority;
- (4) Subpart F—Performance-based Rate Authority;
- (4) Subpart G—Non-compensatory Classes or Products; and
- (5) Subpart H—Accumulation of Unused and Disbursement of Banked Rate Adjustment Authority.

(b) For any product where the attributable cost for that product exceeded the revenue from that product as determined by the Commission, rates may not be reduced.

§ 3010.128 Calculation of percentage change in rates.

(a) For the purpose of calculating the percentage change in rates, the current rate is the rate in effect at the time of the rate adjustment filing under § 3010.121 with the following exceptions.

(1) A seasonal or temporary rate shall be identified and treated as a rate cell separate and distinct from the corresponding non-seasonal or permanent rate. When used with respect to a seasonal or temporary rate, the current rate is the most recent rate in effect for the rate cell, regardless of whether the seasonal or temporary rate is available at the time of the rate adjustment filing.

(2) When used with respect to a rate cell that corresponds to a rate incentive that was previously excluded from the calculation of the percentage change in rates, the current rate is the full undiscounted rate in effect for the rate cell at the time of the rate adjustment filing, not the discounted rate in effect for the rate cell at such time.

(b) For the purpose of calculating the percentage change in rates, the volume for each rate cell shall be obtained from the most recently available 12 months of Postal Service billing determinants with the following permissible adjustments.

(1) The Postal Service shall make reasonable adjustments to the billing determinants to account for the effects of classification changes such as the introduction, deletion, or redefinition of rate cells. The Postal Service shall identify and

explain all adjustments. All information and calculations relied upon to develop the adjustments shall be provided together with an explanation of why the adjustments are appropriate.

(2) Whenever possible, adjustments shall be based on known mail characteristics or historical volume data, as opposed to forecasts of mailer behavior.

(3) For an adjustment accounting for the effects of the deletion of a rate cell when an alternate rate cell is not available, the Postal Service should adjust the billing determinants associated with the rate cell to 0. If the Postal Service does not adjust the billing determinants for the rate cell to 0, the Postal Service shall include a rationale for its treatment of the rate cell with the information required under paragraph (b)(1) of this section.

(c) For a rate adjustment that involves a rate increase, for each class of mail and product within the class, the percentage change in rates is calculated in three steps. First, the volume of each rate cell in the class is multiplied by the planned rate for the respective cell and the resulting products are summed. Second, the same set of rate cell volumes is multiplied by the corresponding current rate for each cell and the resulting products are summed. Third, the percentage change in rates is calculated by dividing the results of the first step by the results of the second step and subtracting 1 from the quotient. The result is expressed as a percentage.

(d) For rate adjustments that only involve a rate decrease, for each class of mail and product within the class, the percentage change in rates is calculated by amending the workpapers attached to the Commission's order relating to the most recent rate

adjustment filing that involved a rate increase to replace the planned rates under the most recent rate adjustment filing that involves a rate increase with the corresponding planned rates applicable to the class from the rate adjustment filing involving only a rate decrease.

(e) The formula for calculating the percentage change in rates for a class, described in paragraphs (c) and (d) of this section, is as follows:

Percentage change in rates =

$$\left(\sum_{i=1}^N (R_{i,n})(V_i) / \sum_{i=1}^N (R_{i,c})(V_i) \right) - 1$$

Where,

N = number of rate cells in the class

i = denotes a rate cell (i = 1, 2, ..., N)

R_{i,n} = planned rate of rate cell i

R_{i,c} = current rate of rate cell i (for rate adjustment involving a rate increase) or rate from most recent rate adjustment involving a rate increase for rate cell i (for a rate adjustment only involving a rate decrease)

V_i = volume of rate cell i

(f) Treatment of rate incentives.

(1) Rate incentives may be excluded from a percentage change in rates calculation. If the Postal Service elects to exclude a rate incentive from a percentage

change in rates calculation, the rate incentive shall be treated in the same manner as a rate under a negotiated service agreement (as described in § 3010.128(g)).

(2) A rate incentive may be included in a percentage change in rates calculation if it meets the following criteria:

(i) The rate incentive is in the form of a discount or can be easily translated into a discount;

(ii) Sufficient billing determinants are available for the rate incentive to be included in the percentage change in rate calculation for the class, which may be adjusted based on known mail characteristics or historical volume data (as opposed to forecasts of mailer behavior); and

(iii) The rate incentive is a rate of general applicability.

(g) Treatment of volume associated with negotiated service agreements and rate incentives that are not rates of general applicability.

(1) Mail volumes sent at rates under a negotiated service agreement or a rate incentive that is not a rate of general applicability are to be included in the calculation of the percentage change in rates under this section as though they paid the appropriate rates of general applicability. Where it is impractical to identify the rates of general applicability (e.g., because unique rate categories are created for a mailer), the volumes associated with the mail sent under the terms of the negotiated service agreement or the rate incentive that is not a rate of general applicability shall be excluded from the calculation of the percentage change in rates.

(2) The Postal Service shall identify and explain all assumptions it makes with respect to the treatment of negotiated service agreements and rate incentives that are not rates of general applicability in the calculation of the percentage change in rates and provide the rationale for its assumptions.

§ 3010.129 Exceptions for de minimis rate increases.

(a) The Postal Service may request that the Commission review a de minimis rate increase without immediately calculating the maximum rate adjustment authority or banking unused rate adjustment authority. For this exception to apply, requests to review de minimis rate adjustments must be filed separately from any other request to review a rate adjustment filing.

(b) Rate adjustments resulting in rate increases are de minimis if:

(1) For each affected class, the rate increases do not result in the percentage change in rates for the class equaling or exceeding 0.001 percent; and

(2) For each affected class, the sum of all rate increases included in de minimis rate increases since the most recent rate adjustment resulting in a rate increase, or the most recent rate adjustment due to extraordinary and exceptional circumstances, that was not a de minimis rate increase does not result in the percentage change in rates for the class equaling or exceeding 0.001 percent.

(c) If the rate adjustments are de minimis, no unused rate adjustment authority will be added to the schedule of banked rate adjustment authority maintained under subpart G of this part as a result of the de minimis rate increase.

(d) If the rate adjustments are de minimis, no rate decreases may be taken into account when determining whether rate increases comply with paragraphs (b)(1) and (2) of this section.

(e) In the next rate adjustment filing proposing to increase rates for a class that is not a de minimis rate increase:

(1) The maximum rate adjustment authority shall be calculated as if the de minimis rate increase had not been filed; and

(2) For purposes of calculating the percentage change in rates, the current rate shall be the current rate from the de minimis rate increase.

(f) The Postal Service shall file supporting workpapers with each request to review a de minimis rate increase that demonstrate that the sum of all rate increases included in de minimis rate increases since the most recent rate adjustment resulting in a rate increase that was not de minimis, or the most recent rate adjustment due to extraordinary and exceptional circumstances, does not result in a percentage change in rates for the class equaling or exceeding 0.001 percent.

(g) For any product where the attributable cost for that product exceeded the revenue from that product as determined by the Commission, rates may not be reduced.

Subpart C—Consumer Price Index Rate Authority

§ 3010.140 Applicability.

The Postal Service may adjust rates based upon changes in the Consumer Price Index for all Urban Consumers (CPI-U) identified in § 3010.141. If rate adjustment filings involving rate increases are filed 12 or more months apart, rate adjustments are subject to a full year limitation calculated pursuant to § 3010.142. If rate adjustment filings involving rate increases are filed less than 12 months apart, rate adjustments are subject to a partial year limitation calculated pursuant to § 3010.143.

§ 3010.141 CPI-U data source.

The monthly CPI-U values needed for the calculation of rate adjustment limitations under this section shall be obtained from the Bureau of Labor Statistics (BLS) Consumer Price Index—All Urban Consumers, U.S. All Items, Not Seasonally Adjusted, Base Period 1982-84 = 100. The current Series ID for the index is “CUUR0000SA0.”

§ 3010.142 CPI-U rate authority when rate adjustment filings are 12 or more months apart.

(a) If a rate adjustment filing involving a rate increase is filed 12 or more months after the most recent rate adjustment filing involving a rate increase, then the calculation of an annual limitation for the class (full year limitation) involves three steps. First, a simple average CPI-U index is calculated by summing the most recently available 12 monthly CPI-U values from the date of the rate adjustment filing and dividing the sum by 12 (Recent Average). Second, a second simple average CPI-U index is similarly calculated by summing the 12 monthly CPI-U values immediately preceding the Recent Average and dividing the sum by 12 (Base Average). Third, the full year limitation is

calculated by dividing the Recent Average by the Base Average and subtracting 1 from the quotient. The result is expressed as a percentage, rounded to three decimal places.

(b) The formula for calculating a full year limitation for a rate adjustment filing filed 12 or more months after the last rate adjustment filing is as follows: Full Year Limitation = (Recent Average/Base Average)–1.

§ 3010.143 CPI-U rate authority when rate adjustment filings are less than 12 months apart.

(a) If a rate adjustment filing involving a rate increase is filed less than 12 months after the most recent rate adjustment filing involving a rate increase, then the annual limitation for the class (partial year limitation) will recognize the rate increases that have occurred during the preceding 12 months. When the effects of those increases are removed, the remaining partial year limitation is the applicable restriction on rate increases.

(b) The applicable partial year limitation is calculated in two steps. First, a simple average CPI-U index is calculated by summing the 12 most recently available monthly CPI-U values from the date of the rate adjustment filing and dividing the sum by 12 (Recent Average). Second, the partial year limitation is then calculated by dividing the Recent Average by the Recent Average from the most recent previous rate adjustment filing (Previous Recent Average) applicable to each affected class of mail and subtracting 1 from the quotient. The result is expressed as a percentage, rounded to three decimal places.

(c) The formula for calculating the partial year limitation for a rate adjustment filing filed less than 12 months after the last rate adjustment filing is as follows: Partial Year Limitation = (Recent Average/Previous Recent Average) – 1.

Subpart D—Density Rate Authority

§ 3010.160 Applicability.

(a) This subpart allocates rate authority to address the effects of decreases in the density of mail as measured by the sources identified in § 3010.161. The calculation of the additional rate authority corresponding to the change in density is described in § 3010.162.

(b) The Postal Service shall file a notice with the Commission by December 31 of each year that calculates the amount of density rate authority that is eligible to be authorized under this subpart.

(c) The Commission shall review the Postal Service's notice and determine how much, if any, rate authority will be authorized under this subpart. Any rate authority allocated under this subpart:

(1) Shall be made available to the Postal Service as of the date of the Commission's determination;

(2) Must be included in the calculation of the maximum rate adjustment authority in the first generally applicable rate adjustment filed after the Commission's determination;

(3) Shall lapse if unused, within 12 months of the Commission's determination;
and

(4) May not be used to generate unused rate authority, nor shall it affect existing banked rate authority.

§ 3010.161 Density calculation data sources.

(a) The data needed for the calculation of the density rate authority in § 3010.162 shall be obtained from the values reported by the Postal Service as specified in paragraphs (b) through (d) of this section. When both originally filed and annually revised data are available, the originally filed data shall be used. When the originally filed data are corrected through a refiling or in the Commission's Annual Compliance Determination report, the corrected version of the originally filed data shall be used.

(b) Market dominant volume and total volume from the Revenue, Pieces, and Weight report, filed by the Postal Service under § 3050.25 of this chapter;

(c) Institutional costs and total costs from the Cost and Revenue Analysis report, filed with the Postal Service's section 3652 report; and

(d) The number of delivery points, from the input data used to produce the Total Factor Productivity estimates, filed with the Postal Service's section 3652 report.

§ 3010.162 Calculation of density rate authority.

(a) *Formulas*—(1) The formula for calculating the amount of density rate authority, in conformance with paragraph (c)(1) of this section, is as follows:

Density rate authority = the greater of 0 and

$$-1 * \frac{IC_T}{TC_T} * \% \Delta D_{[T-1,T]}$$

Where,

T = most recently completed fiscal year

T-1 = fiscal year prior to fiscal year T

IC_T = institutional cost in fiscal year T

TC_T = total cost in fiscal year T

%ΔD_[T-1,T] = Percentage change in density from fiscal year T-1 to fiscal year T

(2) The formula for calculating the percentage change in density, in conformance with paragraph (b)(2) of this section, is as follows:

Percentage change in density from prior fiscal year =

$$\frac{\frac{V_T}{DP_T}}{\frac{V_{T-1}}{DP_{T-1}}} - 1$$

Where,

T = most recently completed fiscal year

T-1 = fiscal year prior to fiscal year T

V_T = volume in fiscal year T (either market dominant volume or total volume as discussed in paragraph (b)(2) of this section)

DP_T = delivery points in fiscal year T

(b) *Calculation*—(1) The amount of density rate authority available under this section shall be calculated in three steps. First, the percentage change in density during the most recently completed fiscal year shall be calculated using the formula in

paragraph (a)(2) of this section as described in paragraph (b)(2) of this section.

Second, this percentage change shall be multiplied by the institutional cost ratio, which is calculated as institutional costs for the most recently completed fiscal year divided by total costs for that fiscal year. Finally, this product shall be multiplied by negative 1 so that declines in density correspond to a positive increase in rates. If the result of this calculation is less than 0, the amount of additional rate authority shall be 0.

(2) The percentage change in density from the prior fiscal year shall be calculated as the ratio of volume to delivery points for the most recently completed fiscal year, divided by the same ratio for the prior fiscal year, and subtracting 1 from the quotient. The result is expressed as a percentage, rounded to three decimal places. To ensure that decreases in competitive product volume will not result in the Postal Service receiving greater additional rate adjustment authority under this subpart, the percentage change in density shall be calculated two ways: using market dominant volume and using total volume. The greater of the two results (not using absolute value) shall be used as the percentage change in density from the prior fiscal year.

Subpart E—Retirement Obligation Rate Authority

§ 3010.180 Definitions.

(a) The definitions in paragraphs (b) through (e) of this section apply to this subpart.

(b) “Amortization payments” mean the amounts that the Postal Service is invoiced by the U.S. Office of Personnel Management to provide for the liquidation of

the specific and supplemental unfunded liabilities by statutorily predetermined dates, as described in § 3010.182(a).

(c) “Phase-in period” means the period of time spanning the fiscal years of issuance of the first five determinations following the effective date of this subpart, as specified by the timing provisions in § 3010.181.

(d) “Required minimum remittance” means the minimum amount the Postal Service is required to remit during a particular fiscal year, as calculated under § 3010.184.

(e) “Revenue collected under this subpart” means the amount of revenue collected during a fiscal year as a result of all previous rate increases authorized under this subpart, as calculated under § 3010.184.

§ 3010.181 Applicability.

(a) This subpart allocates additional rate authority to provide the Postal Service with revenue for remittance towards the statutorily mandated amortization payments for supplemental and unfunded liabilities identified in § 3010.182. As described in § 3010.184, for retirement obligation rate authority to be made available, the Postal Service must annually remit towards these amortization payments all revenue collected under this subpart previously. The full retirement obligation rate authority, calculated as described in § 3010.183, shall be phased in over 5 fiscal years, taking into account changes in volume during the phase-in period. If combined with an equal rate increase on Competitive products, the compounded rate increase resulting from retirement obligation rate authority is calculated to generate sufficient additional revenue at the end

of the phase-in period to permit the Postal Service to remit the entire invoiced amount of its amortization payments.

(b) The Postal Service shall file a notice with the Commission by December 31 of each year, until the conclusion of the phase-in period, that calculates the amount of retirement obligation rate authority that is eligible to be authorized under this subpart.

(c) The Commission shall review the Postal Service's notice and determine how much, if any, rate authority will be authorized under this subpart. Any rate authority allocated under this subpart:

(1) Shall be made available to the Postal Service as of the date of the Commission's determination;

(2) Must be included in the calculation of the maximum rate adjustment authority in the first generally applicable rate adjustment filed after the Commission's determination;

(3) Shall lapse if not used in the first generally applicable rate adjustment filed after the Commission's determination;

(4) Shall lapse if unused, within 12 months of the Commission's determination; and

(5) May not be used to generate unused rate authority, nor shall it affect existing banked rate authority.

§ 3010.182 Retirement obligation data sources.

(a) The amounts of the amortization payments needed for the calculation of retirement obligation rate adjustment authority in § 3010.183 shall be obtained from

notifications to the Postal Service by the Office of Personnel Management of annual determinations of the funding amounts specific to payments at the end of each fiscal year for Retiree Health Benefits as computed under 5 U.S.C. 8909a(d)(2)(B) and (d)(3)(B)(ii); the Civil Service Retirement System as computed under 5 U.S.C. 8348(h)(2)(B); and the Federal Employees Retirement System as computed under 5 U.S.C. 8423(b)(1)(B), (b)(2) and (b)(3)(B), filed with the Postal Service's section 3652 report.

(b) The values for market dominant revenue, total revenue and market dominant volumes needed for the calculation of retirement obligation rate authority in § 3010.183 shall be obtained from values reported in the Revenue, Pieces, and Weight report, filed by the Postal Service under § 3050.25 of this chapter.

(c) The values for additional rate authority previously provided under this subpart, if any, needed for the calculation of retirement obligation rate authority in § 3010.182 and the calculation of required minimum remittances under § 3010.183 shall be obtained from the Commission's prior determinations.

§ 3010.183 Calculation of retirement obligation rate authority.

(a) *Formulas*—(1) The formula for calculating the amount of retirement obligation rate authority available under this subpart, described in paragraph (b)(1) of this section, is as follows:

Additional rate authority in fiscal year T+1 =

$$\left(1 + \frac{AP_T}{TR_T} - PARA_T\right)^{\frac{1}{5-N}} - 1$$

Where,

T = most recently completed fiscal year

AP_T = total amortization payment for fiscal year T

TR_T = total revenue in fiscal year T

PARA_T = previously authorized retirement obligation rate authority, compounded through fiscal year T, expressed as a proportion of the market dominant rate base and calculated using the formula in paragraph (a)(2) of this section as described in paragraph (b)(2) of this section

N = number of previously issued determinations in which retirement obligation rate authority was made available under this subpart

(2) The formula for calculating the amount of previously authorized retirement obligation rate authority through fiscal year T, described in paragraph (b)(2) of this section, is as follows:

Previously authorized retirement obligation rate authority through fiscal year T =

$$1 - \left(\prod_{t=T-N}^T (1 + r_t) \right)^{-1}$$

Where,

T = most recently completed fiscal year

r_t = retirement obligation rate authority authorized in fiscal year t

N = number of previously issued determinations in which retirement obligation rate authority was made available under this subpart

(c) *Calculations*—(1) The amount of retirement obligation rate authority available for a fiscal year shall be calculated in four steps. First, the ratio of the total amortization payment for the fiscal year under review to the total revenue in the fiscal year under review shall be added to 1. This sum represents the factor by which an equal increase in market dominant and competitive rates in the fiscal year under review would generate sufficient additional revenue to make the full amortization payment. It does not account, however, for any previous rate authority authorized under this subpart. The second step is therefore to subtract the proportion of the market dominant rate base resulting from previously authorized retirement obligation rate authority. That proportion is calculated using the formula in § 3010.184(a)(2) as described in § 3010.183(b)(2). Third, to amortize the resulting amount of retirement obligation rate authority over the remainder of the phase-in period, the difference shall be raised to the power of the inverse of the number of determinations remaining in the phase-in period, including the current determination. Finally, 1 shall be subtracted from the result to convert from a proportional change in rates to a percentage of rate adjustment authority.

(2) The amount of previously authorized retirement obligation rate authority shall be calculated in two steps. First, the sums of 1 and the amount of retirement obligation rate authority authorized in each of the previous fiscal years shall be multiplied together. This product represents the compounded amount of such rate authority, expressed as a net rate increase. To express this product as a proportion of the market dominant rate base, the second step is to subtract the inverse of this product from 1.

§ 3010.184 Required minimum remittances.

(a) *Minimum remittances.* During each fiscal year subsequent to the year of the effective date of this subpart, the Postal Service shall remit towards the liabilities identified in § 3010.182 an amount equal to or greater than the amount of revenue collected as a result of all previous rate increases under this subpart during the previous fiscal year, as calculated using the formulas in paragraph (b) of this section, as described in paragraph (c) of this section.

(b) *Formulas*—(1) The formula for calculating the amount of revenue collected under this subpart during a fiscal year, described in paragraph (c)(1) of this section, is as follows:

Amount of revenue =

$$MDR_T \left(1 - \left(\prod_{t=T-N}^T 1 + (p_t)(r_t) \right)^{-1} \right)$$

Where,

T = most recently completed fiscal year

MDR_T = market dominant revenue in fiscal year T

N = number of previously issued determinations in which retirement obligation rate authority was made available under this subpart

r_t = retirement obligation rate authority authorized in fiscal year t

p_t = prorated fraction of r_t that was in effect during fiscal year T, calculated using the formula in paragraph (a)(2) of this section, as described in paragraph (b)(2) of this section

(2) The formula for calculating the prorated fraction of retirement obligation rate authority authorized in a particular fiscal year t that was in effect during the most recently completed fiscal year, described in paragraph (c)(2) of this section, is as follows:

Prorated fraction =

$$\begin{cases} 0, & \text{if } r_t \text{ was not in effect during fiscal year } T \\ 1, & \text{if } r_t \text{ was in effect for all of fiscal year } T \\ \frac{\left(\frac{E_Q}{D_Q}\right)(QMDV_Q) + \sum_{i=Q+1}^4 QMDV_i}{MDV_T}, & \text{if } r_t \text{ came into effect during fiscal year } T \end{cases}$$

Where,

T = most recently completed fiscal year

r_t = retirement obligation rate authority authorized under this subpart in fiscal year t

Q = the number of the quarter during the fiscal year of the effective date of the price increase including retirement obligation rate authority made available under this subpart

E_Q = number of days in quarter Q subsequent to and including the effective date of the price increase

D_Q = total number of days in quarter Q

$QMDV_Q$ = market dominant volume in quarter Q

MDV_T = market dominant volume in fiscal year T

(c) *Calculations*—(1) The amount of revenue collected under this subpart during a fiscal year, as calculated by the formula in paragraph (a)(1) of this section, shall be calculated in three steps. First, the sums of 1 and the amount of retirement obligation rate authority made available under this subpart during each previous fiscal year—

prorated to account for mid-year price increases as described in paragraph (b)(2) of this section—shall be multiplied together. This product represents the proportion by which prices were higher during the most recently completed fiscal year as a result of retirement obligation rate authority. Second, to express this net price increase as a proportion of market dominant revenue, the inverse of this product shall be subtracted from 1. Finally, the result shall be multiplied by market dominant revenue for the fiscal year to change the proportion into a dollar amount.

(2) The prorated fraction of retirement obligation rate authority authorized in a particular fiscal year that was in effect during the most recently completed fiscal year, as calculated by the formula in paragraph (b)(2) of this section, shall be a piecewise function of three parts. First, if the retirement obligation rate authority authorized in a particular year was not in effect during the most recently completed fiscal year, the prorated fraction shall be 0. Second, if the retirement obligation rate authority authorized in a particular year was in effect during the entirety of the most recently completed fiscal year, the prorated fraction shall be 1. Finally, if the retirement obligation rate authority authorized in a particular fiscal year was used to raise prices during the most recently completed fiscal year, the prorated fraction shall be the proportion of volume sent during the fiscal year after that rate increase went into effect.

This proportion shall be calculated in four steps. First, the number of days of the fiscal quarter after and including the effective date of the price adjustment including the retirement obligation rate authority shall be divided by the total number of days in that fiscal quarter. This quotient determines the proportion of days in that quarter in which

the higher rates were in effect. Second, that quotient shall be multiplied by the market dominant volume from that fiscal quarter to determine the amount of volume during the quarter receiving the higher rates. Third, that product shall be added to the market dominant volume from any subsequent quarters of the fiscal year because the volume in those quarters was also sent under the higher rates. Finally, this sum shall be divided by the total market dominant volume from the fiscal year to determine the proportion of annual volume sent after the rate increase went into effect.

§ 3010.185 Forfeiture.

(a) If any of the circumstances described in paragraphs (b) through (d) of this section occur, the Postal Service shall not be eligible for future retirement obligation rate authority under this subpart, and the Commission may commence additional proceedings as appropriate.

(b) If, subsequent to 45 calendar days after the effective date of this subpart and prior to the end of the phase-in period, the Postal Service fails to timely file the notice required under § 3010.181(b);

(c) In any fiscal year in which retirement obligation rate authority was determined to be available under this subpart, the Postal Service fails to timely file under § 3010.122 for a rate increase including the full amount of retirement obligation rate authority authorized under this subpart during that fiscal year, to take effect prior to the end of that fiscal year; or

(d) In any fiscal year including or subsequent to the first fiscal year in which rate authority under this subpart was used to adjust market dominant rates, the Postal

Service's total payments towards the supplemental and unfunded liabilities identified in § 3010.182 are not equal to or greater than the minimum remittance required for that fiscal year under § 3010.184(a).

Subpart F—Performance-based Rate Authority

§ 3010.200 Applicability.

(a) This subpart allocates performance-based rate authority of 1 percentage point for each class of mail, which is available upon meeting or exceeding both an operational efficiency-based requirement and adhering to a service standard-based requirement. This rate authority is allocated based on both meeting the operational efficiency-based requirement appearing in § 3010.201 and meeting the service standard-based requirement appearing in § 3010.202.

(b) The Postal Service shall file a notice with the Commission by December 31 of each year that demonstrates whether or not performance-based rate authority is eligible to be authorized under this subpart.

(c) The Commission shall review the Postal Service's notice and any challenges filed pursuant to § 3010.202(b) and announce how much, if any, rate authority will be authorized under this subpart. Any rate authority allocated under this subpart:

(1) Shall be made available to the Postal Service as of the date of the Commission's announcement;

(2) Must be included in the calculation of the maximum rate adjustment authority in the first generally applicable rate adjustment filed after the Commission's announcement;

(3) Shall lapse if unused, 12 months after the Commission's announcement; and

(4) May not be used to generate unused rate authority, nor shall it affect existing banked rate authority.

§ 3010.201 Operational efficiency-based requirement.

The operational efficiency-based requirement is met if the Postal Service's Total Factor Productivity for the measured fiscal year exceeds the previous fiscal year as determined by the Commission.

§ 3010.202 Service standard-based requirement.

(a) The service standard-related criteria is met if all of the Postal Service's service standards (including applicable business rules) for that class during the applicable fiscal year meet or exceed the service standards in place for the prior fiscal year on a nationwide or substantially nationwide basis as determined by the Commission.

(b) Any interested person may file a challenge to the notice provided by the Postal Service under § 3010.200(b) by March 15 of each year. The scope of such a challenge shall be limited to whether or not the Postal Service's service standards (including applicable business rules) during the applicable fiscal year met or exceeded the service standards in place for the prior fiscal year on a nationwide or substantially

nationwide basis. The Commission shall issue an order which rules on any challenge as soon as practicable.

Subpart G—Non-compensatory Classes or Products

§ 3010.220 Applicability.

This subpart is applicable to a class or product where the attributable cost for that class or product exceeded the revenue from that class or product as determined by the Commission. Section 3010.221 is applicable where the attributable cost for a product within a class exceeded the revenue from that particular product. Section 3010.222 is applicable where the attributable cost for an entire class exceeded the revenue from that class.

§ 3010.221 Individual product requirement.

Whenever the Postal Service files a rate adjustment filing affecting a class of mail which includes a product where the attributable cost for that product exceeded the revenue from that product, as determined by the Commission, the Postal Service shall increase the rates for each non-compensatory product by a minimum of 2 percentage points above the percentage increase for that class. This section does not create additional rate authority applicable to any class of mail.

§ 3010.222 Class requirement and additional class rate authority.

(a) This section provides 2 percentage points of additional rate authority for any class of mail where the attributable cost for that class exceeded the revenue from that

class as determined by the Commission. This additional rate authority is optional and may be used at the Postal Service's discretion.

(b) The Commission shall announce how much, if any, rate authority will be authorized under this subpart. Any rate authority allocated under this subpart:

(1) Shall be made available to the Postal Service as of the date of the Commission's announcement;

(2) Must be included in the calculation of the maximum rate adjustment authority change in rates in the first generally applicable rate adjustment filed after the Commission's announcement;

(3) Shall lapse if unused, within 12 months of the Commission's announcement; and

(4) May not be used to generate unused rate authority, nor shall it affect existing banked rate authority.

Subpart H—Accumulation of Unused and Disbursement of Banked Rate

Adjustment Authority

§ 3010.240 General.

Unless a specific exception applies, unused rate adjustment authority, on a class-by-class basis, shall be calculated for each rate adjustment filing. Unused rate adjustment authority shall be added to the schedule of banked rate authority in each instance, and be available for application to rate adjustments pursuant to the requirements of this subpart.

§ 3010.241 Schedule of banked rate adjustment authority.

Upon the establishment of unused rate adjustment authority, the Postal Service shall devise and maintain a schedule that tracks the establishment and subsequent use of banked rate authority on a class-by-class basis. At a minimum, the schedule must track the amount of banked rate authority available immediately prior to the rate adjustment filing and the amount of banked rate authority available upon acceptance of the rates included in the rate adjustment filing. It shall also track all changes to the schedule, including the docket numbers of Commission decisions affecting the schedule, the dates and amounts that any rate authority was generated or subsequently expended, and the expiration dates of all rate adjustment authority. The schedule shall be included with any rate adjustment filing purporting to modify the amount of banked rate adjustment authority.

§ 3010.242 Calculation of unused rate adjustment authority for rate adjustments that involve a rate increase which are filed 12 months apart or less.

(a) When rate adjustment filings that involve a rate increase are filed 12 months apart or less, unused rate adjustment authority for a class is equal to the difference between the maximum rate adjustment authority as summarized by § 3010.127 and calculated pursuant to subparts C through H of this part, as appropriate, and the percentage change in rates for the class calculated pursuant to § 3010.128, subject to the limitations described in paragraphs (b) and (c) of this section.

(b) Unused rate adjustment authority cannot be generated and is assumed to be 0 percent for classes subject to § 3010.222, Class requirement and additional class rate authority.

(c) For rate adjustment filings that involve a rate increase, unused rate adjustment authority cannot exceed the unused portion of rate authority calculated pursuant to subpart C of this part.

§ 3010.243 Calculation of unused rate adjustment authority for rate adjustments that involve a rate increase which are filed more than 12 months apart.

(a) When rate adjustment filings that involve a rate increase are filed more than 12 months apart, any interim rate adjustment authority must first be added to the schedule of banked rate authority before the unused rate adjustment authority is calculated.

(b) Interim rate adjustment authority for a class is equal to the Base Average applicable to the second rate adjustment filing (as developed pursuant to § 3010.142) divided by the Recent Average utilized in the first rate adjustment filing (as developed pursuant to § 3010.142) and subtracting 1 from the quotient. The result is expressed as a percentage and immediately added to the schedule of banked rate authority as of the date the rate adjustment filing is filed.

(c) Unused rate adjustment authority for a class is equal to the difference between the maximum rate adjustment authority as summarized by § 3010.127 and calculated pursuant to subparts C through H of this part, as appropriate, and the

percentage change in rates for the class calculated pursuant to § 3010.128, subject to the limitations described in paragraphs (d) and (e) of this section.

(d) Unused rate adjustment authority cannot be generated and is assumed to be 0 percent for classes subject to § 3010.222, Class requirement and additional class rate authority.

(e) For rate adjustment filings that involve a rate increase, unused rate adjustment authority cannot exceed the unused portion of rate authority calculated pursuant to subpart C of this part.

§ 3010.244 Calculation of unused rate adjustment authority for rate adjustments that only include rate decreases.

(a) For rate adjustment filings that only include rate decreases, unused rate adjustment authority for a class is calculated in two steps. First, the difference between the maximum rate adjustment authority as summarized by § 3010.127 and calculated pursuant to subparts C through H of this part, as appropriate, for the most recent rate adjustment that involves a rate increase and the percentage change in rates for the class calculated pursuant to § 3010.128(d) is calculated. Second, the unused rate adjustment authority generated in the most recent rate adjustment that involves a rate increase is subtracted from that result.

(b) Unused rate adjustment authority generated under paragraph (a) of this section for a class shall be added to the unused rate adjustment authority generated in the most recent rate adjustment that involves a rate increase on the schedule maintained under § 3010.241. For purposes of § 3010.244, the unused rate adjustment

authority generated under paragraph (a) of this section for a class shall be deemed to have been added to the schedule maintained under § 3010.241 on the same date as the most recent rate adjustment filing that involves a rate increase.

(c) For rate adjustment filings that only include rate decreases, the sum of unused rate adjustment authority generated under paragraph (a) of this section and the unused rate adjustment authority generated in the most recent rate adjustment that involves a rate increase cannot exceed the unused portion of rate adjustment authority calculated pursuant to subpart C of this part in the most recent rate adjustment that involves a rate increase.

(d) Unused rate adjustment authority generated under paragraph (a) of this section shall be subject to the limitation under § 3010.245, regardless of whether it is used alone or in combination with other existing unused rate adjustment authority.

(e) For rate adjustment filings that only include rate decreases, unused rate adjustment authority generated under this section lapses 5 years from the date of filing of the most recent rate adjustment filing that involves a rate increase.

(f) A rate adjustment filing that only includes rate decreases that is filed immediately after a rate adjustment due to extraordinary or exceptional circumstances (*i.e.*, without an intervening rate adjustment involving a rate increase) may not generate unused rate adjustment authority.

§ 3010.245 Application of banked rate authority.

(a) Banked rate authority may be applied to any planned rate adjustment subject to the limitations appearing in paragraphs (b) through (f) of this section.

(b) Banked rate authority may only be applied to a proposal to adjust rates after applying rate authority as described in subparts C through F of this part and in § 3010.222, Class requirement and additional class rate authority .

(c) A maximum of 2 percentage points of banked rate authority may be applied to a rate adjustment for any class in any 12-month period. If banked rate authority is used, it shall be subtracted from the schedule of banked rate adjustment authority as of the date of the final order accepting the rates.

(d) Subject to paragraphs (b) and (c) of this section, interim rate adjustment authority may be used to make a rate adjustment pursuant to the rate adjustment filing that led to its calculation. If interim rate adjustment authority is used to make such a rate adjustment, the interim rate adjustment authority generated pursuant to the rate adjustment filing shall first be added to the schedule of banked rate adjustment authority pursuant to § 3010.241 as the most recent entry. Then, any interim rate adjustment authority used in accordance with this paragraph shall be subtracted from the existing banked rate adjustment authority using a first-in, first-out (FIFO) method, beginning 5 years before the instant rate adjustment filing.

(e) Banked rate authority for a class must be applied, using a first-in, first-out (FIFO) method, beginning 5 years before the instant rate adjustment filing.

(f) Banked rate adjustment authority calculated under this section shall lapse 5 years from the date of the rate adjustment filing leading to its calculation.

Subpart I—Rate Adjustments Due to Extraordinary and Exceptional Circumstances

§ 3010.260 General.

The Postal Service may request to adjust rates for market dominant products due to extraordinary or exceptional circumstances pursuant to 39 U.S.C. 3622(d)(1)(E). The rate adjustments are not subject to rate adjustment limitations or the restrictions on the use of unused rate adjustment authority. The rate adjustment request may not include material classification changes. The request is subject to public participation and Commission review within 90 days.

§ 3010.261 Contents of a request.

- (a) Each exigent request shall include the items specified in paragraphs (b) through (i) of this section.
- (b) A schedule of the planned rates.
- (c) Calculations quantifying the increase for each affected product and class.
- (d) A full discussion of the extraordinary or exceptional circumstances giving rise to the request, and a complete explanation of how both the requested overall increase and the specific rate adjustments requested relate to those circumstances.
- (e) A full discussion of why the requested rate adjustments are necessary to enable the Postal Service, under best practices of honest, efficient, and economical management, to maintain and continue the development of postal services of the kind and quality adapted to the needs of the United States.

(f) A full discussion of why the requested rate adjustments are reasonable and equitable as among types of users of market dominant products.

(g) An explanation of when, or under what circumstances, the Postal Service expects to be able to rescind the exigent rate adjustments in whole or in part.

(h) An analysis of the circumstances giving rise to the exigent request, which should, if applicable, include a discussion of whether the circumstances were foreseeable or could have been avoided by reasonable prior action.

(i) Such other information as the Postal Service believes will assist the Commission in issuing a timely determination of whether the requested rate adjustments are consistent with applicable statutory policies.

§ 3010.262 Supplemental information.

The Commission may require the Postal Service to provide clarification of its request or to provide additional information in order to gain a better understanding of the circumstances leading to the request or the justification for the specific rate adjustments requested. The Postal Service shall include within its request the identification of one or more knowledgeable Postal Service official(s) who will be available to provide prompt responses to Commission requests for clarification or additional information.

§ 3010.263 Docket and notice.

(a) The Commission will establish a docket for each request to adjust rates due to extraordinary or exceptional circumstances, publish notice of the request in the **Federal Register**, and post the filing on its website. The notice shall include the items specified in paragraphs (b) through (g) of this section.

- (b) The general nature of the proceeding.
- (c) A reference to legal authority under which the proceeding is to be conducted.
- (d) A concise description of the proposals for changes in rates, fees, and the Mail Classification Schedule.
- (e) The identification of an officer of the Commission to represent the interests of the general public in the docket.
- (f) A specified period for public comment.
- (g) Such other information as the Commission deems appropriate.

§ 3010.264 Public hearing.

(a) The Commission will hold a public hearing on the Postal Service's request. During the public hearing, responsible Postal Service officials will appear and respond under oath to questions from the Commissioners or their designees addressing previously identified aspects of the Postal Service's request and supporting information.

(b) Interested persons will be given an opportunity to submit to the Commission suggested relevant questions that might be posed during the public hearing. Such questions, and any explanatory materials submitted to clarify the purpose of the questions, should be filed in accordance with § 3001.9 of this chapter, and will become part of the administrative record of the proceeding.

(c) The timing and length of the public hearing will depend on the nature of the circumstances giving rise to the request and the clarity and completeness of the supporting materials provided with the request.

(d) If the Postal Service is unable to provide adequate explanations during the public hearing, supplementary written or oral responses may be required.

§ 3010.265 Opportunity for comments.

(a) Following the conclusion of the public hearings and submission of any supplementary materials, interested persons will be given the opportunity to submit written comments on:

- (1) The sufficiency of the justification for an exigent rate adjustment;
- (2) The adequacy of the justification for adjustments in the amounts requested by the Postal Service; and
- (3) Whether the specific rate adjustments requested are reasonable and equitable.

(b) An opportunity to submit written reply comments will be given to the Postal Service and other interested persons.

§ 3010.266 Deadline for Commission decision.

Requests under this subpart seek rate relief required by extraordinary or exceptional circumstances and will be treated with expedition at every stage. It is Commission policy to provide appropriate relief as quickly as possible consistent with statutory requirements and procedural fairness. The Commission will act expeditiously on the Postal Service's request, taking into account all written comments. In every instance, a Commission decision will be issued within 90 days of the filing of an exigent request.

§ 3010.267 Treatment of banked rate adjustment authority.

(a) Each request will identify the banked rate adjustment authority available as of the date of the request for each class of mail and the available amount for each of the preceding 5 years.

(b) Rate adjustments may use existing banked rate adjustment authority in amounts greater than the limitations described in § 3010.245.

(c) Increases will exhaust all banked rate adjustment authority for each class of mail before imposing additional rate adjustments in excess of the maximum rate adjustment for any class of mail.

Subpart J—Workshare Discounts

§ 3010.280 Applicability.

This subpart is applicable whenever the Postal Service proposes to adjust a rate associated with a workshare discount. For the purpose of this subpart, the cost avoided by the Postal Service for not providing the applicable service refers to the amount identified in the most recently applicable Annual Compliance Determination, unless the Commission otherwise provides.

§ 3010.281 Calculation of passthroughs for workshare discounts.

For the purpose of this subpart, the percentage passthrough for any workshare discount shall be calculated by dividing the workshare discount by the cost avoided by the Postal Service for not providing the applicable service and expressing the result as a percentage.

§ 3010.282 Increased pricing efficiency.

(a) For a workshare discount that is equal to the cost avoided by the Postal Service for not providing the applicable service, no proposal to adjust a rate associated with that workshare discount may change the size of the discount.

(b) For a workshare discount that exceeds the cost avoided by the Postal Service for not providing the applicable service, no proposal to adjust a rate associated with that workshare discount may increase the size of the discount.

(c) For a workshare discount that is less than the cost avoided by the Postal Service for not providing the applicable service, no proposal to adjust a rate associated with that workshare discount may decrease the size of the discount.

§ 3010.283 Limitations on excessive discounts.

(a) No proposal to adjust a rate may set a workshare discount that would exceed the cost avoided by the Postal Service for not providing the applicable service, unless at least one of the following reasons provided in paragraphs (b) through (e) of this section applies.

(b) The proposed workshare discount is associated with a new postal service, a change to an existing postal service, or a new workshare initiative.

(c) The proposed workshare discount is a minimum of 20 percent less than the existing workshare discount.

(d) The proposed workshare discount is set in accordance with a Commission order issued pursuant to § 3010.286.

(e) The proposed workshare discount is provided in connection with a subclass of mail, consisting exclusively of mail matter of educational, cultural, scientific, or informational value (39 U.S.C. 3622(e)(2)(C)) and is in compliance with § 3010.285(c).

§ 3010.284 Limitations on discounts below avoided cost.

(a) No proposal to adjust a rate may set a workshare discount that would be below the cost avoided by the Postal Service for not providing the applicable service, unless at least one of the following reasons provided in paragraphs (b) through (e) of this section applies.

(b) The proposed workshare discount is associated with a new postal service, a change to an existing postal service, or a new workshare initiative.

(c) The proposed workshare discount is a minimum of 20 percent more than the existing workshare discount.

(d) The proposed workshare discount is set in accordance with a Commission order issued pursuant to § 3010.286.

(e) The percentage passthrough for the proposed workshare discount is at least 85 percent.

§ 3010.285 Proposal to adjust a rate associated with a workshare discount.

(a) Each proposal to adjust a rate associated with a workshare discount shall be supported by substantial evidence and demonstrate that each proposed workshare discount has been set in compliance with 39 U.S.C. 3622(e) and this subpart. Substantial evidence means such relevant evidence as a reasonable mind might accept as adequate to support a conclusion.

(b) For each proposed workshare discount that would exceed the cost avoided by the Postal Service for not providing the applicable service, the rate adjustment filing shall indicate the applicable paragraph of § 3010.283 under which the Postal Service is justifying the excessive discount and include any relevant analysis supporting the claim.

(c) For each proposed workshare discount that is provided in connection with a subclass of mail, consisting exclusively of mail matter of educational, cultural, scientific, or informational value (39 U.S.C. 3622(e)(2)(C)), would exceed the cost avoided by the Postal Service for not providing the applicable service, and would not be set in accordance with at least one specific provision appearing in § 3010.283(b) through (d), the rate adjustment filing shall provide the information specified in paragraphs (c)(1) through (3) of this section:

(1) The number of mail owners receiving the workshare discount during the most recent full fiscal year and for the current fiscal year to date;

(2) The number of mail owners for the applicable product or products in the most recent full fiscal year and for the current fiscal year to date; and

(3) An explanation of how the proposed workshare discount would promote the public interest, even though the proposed workshare discount would substantially exceed the cost avoided by the Postal Service.

(d) For each proposed workshare discount that would be below the cost avoided by the Postal Service for not providing the applicable service, the rate adjustment filing shall indicate the applicable paragraph of § 3010.284 under which the Postal Service is

justifying the discount that is below the cost avoided and include any relevant analysis supporting the claim.

§ 3010.286 Application for waiver.

(a) In every instance in which the Postal Service determines to adjust a rate associated with a workshare discount in a manner that does not comply with the limitations imposed by §§ 3010.283 through 3010.284, the Postal Service shall file an application for waiver. The Postal Service must file any application for waiver at least 60 days prior to filing the proposal to adjust a rate associated with the applicable workshare discount. In its application for waiver, the Postal Service shall indicate the approximate filing date for its next rate adjustment filing.

(b) The application for waiver shall be supported by a preponderance of the evidence and demonstrate that a waiver from the limitations imposed by §§ 3010.283 through 3010.284 should be granted. Preponderance of the evidence means proof by information that, compared with that opposing it, leads to the conclusion that the fact at issue is more probably true than not.

(c) The application for waiver shall include a specific and detailed statement signed by one or more knowledgeable Postal Service official(s) who sponsors the application and attests to the accuracy of the information contained within the statement. The statement shall set forth the information specified in paragraphs (c)(1) through (8) of this section, as applicable to the specific workshare discount for which a waiver is sought:

(1) The reason(s) why a waiver is alleged to be necessary (with justification thereof), including all relevant supporting analysis and all assumptions relied upon.

(2) The length of time for which a waiver is alleged to be necessary (with justification thereof).

(3) For each subsequent rate adjustment filing planned to occur during the length of time for which a waiver is sought, a representation of the proposed minimum amount of the change to the workshare discount.

(4) For a claim that the amount of the workshare discount exceeding the cost avoided by the Postal Service for not providing the applicable service is necessary in order to mitigate rate shock (39 U.S.C. 3622(e)(2)(B)), the Postal Service shall provide an explanation addressing all of the items specified in paragraphs (c)(4)(i) through (iii) of this section:

(i) A description of the customers that the Postal Service claims would be adversely affected.

(ii) Prices and volumes for the workshare discount at issue (the benchmark and workshared mail category) for the last 10 years.

(iii) Quantitative analysis or, if not available, qualitative analysis indicating the nature and extent of the likely harm to the customers that would result from setting the workshare discount in compliance with § 3010.283(c).

(5) For a claim that setting an excessive or low workshare discount closer or equal to the cost avoided by the Postal Service for not providing the applicable service would impede the efficient operation of the Postal Service, the Postal Service shall

provide an explanation addressing all of the items specified in paragraphs (c)(5)(i) through (iii) of this section:

(i) A description of the operational strategy at issue.

(ii) Quantitative analysis or, if not available, qualitative analysis indicating how the workshare discount at issue is related to that operational strategy.

(iii) How setting the workshare discount in compliance with § 3010.283(c) or § 3010.284(c), whichever is applicable, would impede that operational strategy.

(6) For a claim that reducing or eliminating the excessive workshare discount would lead to a loss of volume in the affected category of mail and reduce the aggregate contribution to the Postal Service's institutional costs from the mail that is subject to the discount (39 U.S.C. 3622(e)(3)(A)), the Postal Service shall provide an explanation addressing all of the items specified in paragraphs (c)(6)(i) through (iii) of this section:

(i) A description of the affected category of mail.

(ii) Quantitative analysis or, if not available, qualitative analysis indicating the expected loss of volume and reduced contribution that is claimed would result from reducing or eliminating the excessive workshare discount.

(iii) How setting the excessive workshare discount in compliance with § 3010.283(c) would lead to the expected loss of volume and reduced contribution.

(7) For a claim that reducing or eliminating the excessive workshare discount would result in a further increase in the rates paid by mailers not able to take advantage of the workshare discount (39 U.S.C. 3622(e)(3)(B)), the Postal Service shall provide an

explanation addressing all of the items specified in paragraphs (c)(7)(i) through (iii) of this section:

(i) A description of the mailers not able to take advantage of the discount.

(ii) Quantitative analysis or, if not available, qualitative analysis indicating the expected size of the rate increase that is claimed would result in the rates paid by mailers not able to take advantage of the discount.

(iii) How setting the excessive workshare discount in compliance with § 3010.283(c) would result in a further increase in the rates paid by mailers not able to take advantage of the discount.

(8) Any other relevant factors or reasons to support the application for waiver.

(d) Unless the Commission otherwise provides, commenters will be given at least 7 calendar days to respond to the application for waiver after it has been filed by the Postal Service.

(e) To better evaluate the waiver application, the Commission may, on its own behalf or by request of any interested person, order the Postal Service to provide experts on the subject matter of the waiver application to participate in technical conferences, prepare statements clarifying or supplementing their views, or answer questions posed by the Commission or its representatives.

(f) For a proposed workshare discount that would exceed the cost avoided by the Postal Service for not providing the applicable service, the application for waiver shall be granted only if at least one provision appearing in 39 U.S.C. 3622(e)(2)(A) through (e)(2)(D) or 39 U.S.C. 3622(e)(3)(A) through (e)(3)(B) is determined to apply.

(g) For a proposed workshare discount that would be set below the cost avoided by the Postal Service for not providing the applicable service, the application for waiver shall be granted only if setting the workshare discount closer or equal to the cost avoided by the Postal Service for not providing the applicable service would impede the efficient operation of the Postal Service.

(h) The Commission will issue an order announcing, at a minimum, whether the requested waiver will be granted or denied no later than 21 days following the close of any comment period(s). An order granting the application for waiver shall specify all conditions upon which the waiver is granted, including the date upon which the waiver shall expire.

PART 3020—PRODUCT LISTS

2. The authority citation for part 3020 continues to read as follows:

Authority: 39 U.S.C. 503; 3622; 3631; 3642; 3682.

3. Amend § 3020.32 by revising paragraphs (a) and (b) to read as follows:

§ 3020.32 Supporting justification.

* * * * *

(a) Explain the reason for initiating the docket and explain why the change is not inconsistent with the applicable requirements of this part and any applicable Commission directives and orders;

(b) Explain why, as to market dominant products, the change is not inconsistent with the policies and the applicable criteria of chapter 36 of title 39 of the United States Code;

* * * * *

4. Amend § 3020.52 by revising paragraphs (a) and (b) to read as follows:

§ 3020.52 Supporting justification.

* * * * *

(a) Explain the reason for initiating the docket and explain why the change is not inconsistent with the applicable requirements of this part and any applicable Commission directives and orders;

(b) Explain why, as to market dominant products, the change is not inconsistent with the policies and the applicable criteria of chapter 36 of title 39 of the United States Code;

* * * * *

5. Amend § 3020.72 by revising paragraphs (a) and (b) to read as follows:

§ 3020.72 Supporting justification.

* * * * *

(a) Explain the reason for initiating the docket and explain why the change is not inconsistent with the applicable requirements of this part and any applicable Commission directives and orders;

(b) Explain why, as to market dominant products, the change is not inconsistent with the policies and the applicable criteria of chapter 36 of title 39 of the United States Code;

* * * * *

6. Amend § 3020.81 by revising paragraph (b)(1) to read as follows:

§ 3020.81 Supporting justification for material changes to product descriptions.

* * * * *

(b)(1) As to market dominant products, explain why the changes are not inconsistent with the policies and the applicable criteria of chapter 36 of title 39 of the United States Code, the applicable requirements of this part, and any applicable Commission directives and orders; or

* * * * *

7. Amend § 3020.82 by revising paragraph (e) to read as follows:

§ 3020.82 Docket and notice of material changes to product descriptions.

* * * * *

(e) Provide interested persons with an opportunity to comment on whether the proposed changes are consistent with the policies and the applicable criteria of chapter 36 of title 39 of the United States Code, the applicable requirements of this part, and any applicable Commission directives and orders.

8. Amend § 3020.90 by revising paragraph (c)(2) to read as follows:

§3020.90 Minor corrections to product descriptions.

* * * * *

(c) * * *

(2) Explain why the proposed corrections are consistent with the policies and the applicable criteria of chapter 36 of title 39 of the United States Code, the applicable requirements of this part, and any applicable Commission directives and orders; and

* * * * *

9. Amend § 3020.91 by revising paragraph (e) to read as follows:

§3020.91 Docket and notice of minor corrections to product descriptions.

* * * * *

(e) Provide interested persons with an opportunity to comment on whether the proposed corrections are consistent with the policies and the applicable criteria of chapter 36 of title 39 of the United States Code, the applicable requirements of this part, and any applicable Commission directives and orders.

10. Add subpart G to read as follows:

Subpart G—Requests for Market Dominant Negotiated Service Agreements
Sec.

3020.120 General.

3020.121 Additional supporting justification for negotiated service agreements.

3020.122 Data collection plan and report for negotiated service agreements.

§ 3020.120 General.

This subpart imposes additional requirements whenever there is a request to add a negotiated service agreement to the market dominant product list. The additional supporting justification appearing in § 3020.121 also should be provided whenever the Postal Service proposes to modify the terms of an existing market dominant negotiated service agreement. Commission findings that the addition of a special classification is

not inconsistent with 39 U.S.C. 3622 are provisional and subject to subsequent review. No rate(s) shall take effect until 45 days after the Postal Service files a request for review of a notice of a new rate or rate(s) adjustment specifying the rate(s) and the effective date.

§ 3020.121 Additional supporting justification for negotiated service agreements.

(a) Each request shall also include the items specified in paragraphs (b) through (j) of this section.

(b) A copy of the negotiated service agreement.

(c) The planned effective date(s) of the planned rates.

(d) The identity of a responsible Postal Service official who will be available to provide prompt responses to requests for clarification from the Commission.

(e) A statement identifying all parties to the agreement and a description clearly explaining the operative components of the agreement.

(f) Details regarding the expected improvements in the net financial position or operations of the Postal Service (39 U.S.C. 3622(c)(10)(A)(i) and (ii)). The projection of the change in net financial position as a result of the agreement shall be based on accepted analytical principles. The projection of the change in net financial position as a result of the agreement shall include for each year of the agreement:

(1) The estimated mailer-specific costs, volumes, and revenues of the Postal Service absent the implementation of the negotiated service agreement;

(2) The estimated mailer-specific costs, volumes, and revenues of the Postal Service which result from implementation of the negotiated service agreement;

(3) An analysis of the effects of the negotiated service agreement on the contribution to institutional costs from mailers not party to the agreement;

(4) If mailer-specific costs are not available, the source and derivation of the costs that are used shall be provided, together with a discussion of the currency and reliability of those costs and their suitability as a proxy for the mailer-specific costs; and

(5) If the Postal Service believes the Commission's accepted analytical principles are not the most accurate and reliable methodology available:

(i) An explanation of the basis for that belief; and

(ii) A projection of the change in net financial position resulting from the agreement made using the Postal Service's alternative methodology.

(g) An identification of each component of the agreement expected to enhance the performance of mail preparation, processing, transportation, or other functions in each year of the agreement, and a discussion of the nature and expected impact of each such enhancement.

(h) Details regarding any and all actions (performed or to be performed) to assure that the agreement will not result in unreasonable harm to the marketplace (39 U.S.C. 3622(c)(10)(B)).

(i) A discussion in regard to how functionally similar negotiated service agreements will be made available on public and reasonable terms to similarly situated mailers.

(j) Such other information as the Postal Service believes will assist the Commission in issuing a timely determination of whether the requested changes are consistent with applicable statutory policies.

§ 3020.122 Data collection plan and report for negotiated service agreements.

(a) The Postal Service shall include with any request concerning a negotiated service agreement a detailed plan for providing data or information on actual experience under the agreement sufficient to allow evaluation of whether the negotiated service agreement operates in compliance with 39 U.S.C. 3622(c)(10).

(b) A data report under the plan is due 60 days after each anniversary date of implementation and shall include, at a minimum, the following information for each 12-month period the agreement has been in effect:

(1) The change in net financial position of the Postal Service as a result of the agreement. This calculation shall include for each year of the agreement:

(i) The actual mailer-specific costs, volumes, and revenues of the Postal Service;

(ii) An analysis of the effects of the negotiated service agreement on the net overall contribution to the institutional costs of the Postal Service; and

(iii) If mailer-specific costs are not available, the source and derivation of the costs that are used shall be provided, including a discussion of the currency and reliability of those costs and their suitability as a proxy for the mailer-specific costs.

(2) A discussion of the changes in operations of the Postal Service that have resulted from the agreement. This shall include, for each year of the agreement,

identification of each component of the agreement known to enhance the performance of mail preparation, processing, transportation, or other functions in each year of the agreement.

(3) An analysis of the impact of the negotiated service agreement on the marketplace, including a discussion of any and all actions taken to protect the marketplace from unreasonable harm.

PART 3050—PERIODIC REPORTING

11. The authority citation for part 3050 continues to read as follows:

Authority: 39 U.S.C. 503; 3651; 3652; 3653.

12. Amend § 3050.20 by revising paragraph (c) to read as follows:

§ 3050.20 Compliance and other analyses in the Postal Service's section 3652 report.

* * * * *

(c) It shall address such matters as non-compensatory rates and failures to achieve stated goals for on-time delivery standards. A more detailed analysis is required when the Commission observed and commented upon the same matter in its Annual Compliance Determination for the previous fiscal year.

13. Amend § 3050.21 by:

- a. Revising paragraphs (a), (e), and (m); and
- b. Adding paragraphs (n) and (o).

The revisions and additions read as follows:

§ 3050.21 Content of the Postal Service's section 3652 report.

(a) No later than 90 days after the close of each fiscal year, the Postal Service shall submit a report to the Commission analyzing its cost, volume, revenue, rate, and service information in sufficient detail to demonstrate that all products during such year comply with all applicable provisions of title 39 of the United States Code. The report shall provide the items in paragraphs (b) through (o) of this section.

* * * * *

(e) For each market dominant workshare discount offered during the reporting year:

(1) The per-item cost avoided by the Postal Service by virtue of such discount;
(2) The percentage of such per-item cost avoided that the per-item workshare discount represents;

(3) The per-item contribution made to institutional costs;

(4) The factual and analytical bases for any claim that one or more of the exception provisions of 39 U.S.C. 3622(e)(2)(A) through (e)(2)(D) or 39 U.S.C. 3622(e)(3)(A) through (e)(3)(B) apply; and

(5) For each workshare discount that is provided in connection with a subclass of mail, consisting exclusively of mail matter of educational, cultural, scientific, or informational value (39 U.S.C. 3622(e)(2)(C)), exceeded the cost avoided by the Postal Service for not providing the applicable service, and was not set in accordance with at

least one specific provision appearing in § 3010.262(b) through (d) of this chapter, the information specified in paragraphs (5)(i) through (iii) of this section:

- (i) The number of mail owners receiving the workshare discount;
- (ii) The number of mail owners for the applicable product or products; and
- (iii) An explanation of how the workshare discount promotes the public interest, even though the workshare discount substantially exceeds the cost avoided by the Postal Service.

* * * * *

- (l) For the Inbound Letter Post product, provide revenue, volume, attributable cost, and contribution data by Universal Postal Union country group and by shape for the fiscal year subject to review and each of the preceding 4 fiscal years;

- (m) Input data and calculations used to produce the annual Total Factor Productivity estimates;

- (n) Copies of notifications to the Postal Service by the Office of Personnel Management (OPM) of annual determinations of the funding amounts specific to payments at the end of each fiscal year computed under 5 U.S.C. 8909a(d)(2)(B) and 5 U.S.C. 8909a(d)(3)(B)(ii); 5 U.S.C. 8348(h)(2)(B) and 5 U.S.C. 8423(b)(3)(B); 5 U.S.C. 8423(b)(1)(B) and 5 U.S.C. 8423(b)(2); and

- (o) Provide any other information that the Postal Service believes will help the Commission evaluate the Postal Service's compliance with the applicable provisions of title 39 of the United States Code.

14. Add § 3050.55 to read as follows:

§ 3050.55 Information pertaining to cost reduction initiatives.

(a) The reports in paragraphs (b) through (f) of this section shall be filed with the Commission at the times indicated.

(b) Within 95 days after the end of each fiscal year, the Postal Service shall file a financial report that analyzes cost data from the fiscal year. For purposes of this paragraph, the percentage change shall compare the fiscal year under review to the previous fiscal year. At a minimum, the report shall include:

(1) For all market dominant mail, the percentage change in total unit attributable cost;

(2) For each market dominant mail product, the percentage change in unit attributable cost;

(3) For the system as a whole, total average cost per piece, which includes all Postal Service competitive and market dominant attributable costs and institutional costs,

(4) The percentage change in total average cost per piece;

(5) Market dominant unit attributable cost by product;

(6) If the percentage change in unit attributable cost for a market dominant mail product is more than 0.0 percent and exceeds the percentage change in total market dominant mail unit attributable cost, then the following information shall be provided:

(i) Unit attributable cost workpapers for the product disaggregated into the following cost categories: mail processing unit cost, delivery unit cost, vehicle service

driver unit cost, purchased transportation unit cost, window service unit cost, and other unit cost;

(ii) A narrative that identifies cost categories that are driving above average increases in unit attributable cost for the product and explains the reason for the above-average increase; and

(iii) A specific plan to reduce unit attributable cost for the product.

(7) An analysis of volume trends and mail mix changes for each market dominant mail product from fiscal year 2017 through the end of the fiscal year under review, which shall include at a minimum:

(i) A comparison of actual unit attributable costs and estimated unit attributable costs for each market dominant mail product, using the volume distribution from fiscal year 2017;

(ii) A narrative that identifies the drivers of change in volume trends and the mail mix; and

(iii) A narrative that explains the methodology used to calculate the estimated unit attributable costs as required by paragraph (b)(7)(i) of this section.

(c) Within 95 days after the end of each fiscal year, the Postal Service shall file a report with analysis of each planned cost reduction initiative that is expected to require Postal Service total expenditures of \$5 million or more over the duration of the initiative. At a minimum, the report shall include:

(1) A narrative that describes each cost reduction initiative planned for future fiscal years, including the status, the expected total expenditure, start date, end date, and any intermediate deadlines;

(2) Identification of a metric to measure the impact of each planned cost reduction initiative identified in paragraph (c)(1) of this section, a narrative describing the selected metric, a narrative explaining the reason for selecting that metric, and a schedule approximating the months and fiscal years in which the cost reduction impact is expected to be measureable;

(3) Estimates of the expected impact of each planned cost reduction initiative, with supporting workpapers, using the metric identified in paragraph (c)(2) of this section, total market dominant mail attributable unit cost, and total unit cost as calculated pursuant to paragraph (b)(3) of this section.

(d) Within 95 days after the end of each fiscal year, the Postal Service shall file a report that describes each active cost reduction initiative during the fiscal year which incurred or is expected to incur Postal Service expenditures of \$5 million or more over the duration of the initiative. At a minimum, the report shall include:

(1) The information described in paragraphs (c)(1) through (c)(3) of this section, based on actual data for the fiscal year, and a specific statement as to whether the initiative actually achieved the expected impact as measured by the selected metric;

(2) An explanation of the trends, changes, or other reasons that caused any variance between the actual information provided under paragraph (d)(1) of this section

and the estimated information previously provided under paragraphs (c)(1) through (c)(3) of this section, if applicable;

(3) A description of any mid-implementation adjustments the Postal Service has taken or will take to align the impacts with the schedule; and

(4) Any revisions to the schedule of cost reduction impacts for future fiscal years.

(e) Within 95 days after the end of each fiscal year, the Postal Service shall file a report that summarizes all projects associated with a Decision Analysis Report for the fiscal year. At a minimum, the report shall include:

(1) A description of each project;

(2) The status of each project;

(3) An estimate of cost savings or additional revenues from each project; and

(4) The return on investment expected from each project.

(f) Within 95 days after the end of each fiscal year, the Postal Service shall file a report that summarizes all planned projects that will require a Decision Analysis Report in the next fiscal year. At a minimum, the report shall include:

(1) A description of each planned project;

(2) The status of each project;

(3) An estimate of the cost savings or additional revenues expected from each project; and

(4) The return on investment expected from each project.

15. Amend § 3050.60 by:

a. Revising paragraph (a);

- b. Removing paragraph (e);
- c. Redesignating paragraph (f) as paragraph (e); and
- d. Redesignating paragraph (g) as paragraph (f).

The revisions, removal, and redesignations read as follows:

§ 3050.60 Miscellaneous reports and documents.

(a) The reports in paragraphs (b) through (f) of this section shall be provided at the times indicated.

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**PART 3055—SERVICE PERFORMANCE AND CUSTOMER SATISFACTION
REPORTING**

16. The authority citation for part 3055 continues to read as follows:

Authority: 39 U.S.C. 503; 3622(a); 3652(d) and (e); 3657(c).

17. Amend § 3055.2 by revising paragraph (c) to read as follows:

§ 3055.2 Contents of the annual report of service performance achievements.

* * * * *

(c) The applicable service standard(s) for each product. If there has been a change to a service standard(s) since the previous report, a description of and reason for the change shall be provided. If there have been no changes to service standard(s) since the previous report, a certification stating this fact shall be provided.

* * * * *